Docket for 02-1016

No. 02-1016 Status: ARGUED
Title: Lee M. Till, et ux., Petitioners
v.
SCS Credit Corporation
Docketed: January 6, 2003
Lower Ct: United States Court of Appeals for the Seventh Circuit
Case Nos.: (00-4167)
Decision Date: August 21, 2002
Rehearing Denied: October 10, 2002

~~Date~~~	~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~~
Jan 2 2003	Petition for writ of certiorari filed. (Response due February 5, 2003)
Jan 29 2003	Supplemental brief of petitioners Lee M. Till, et ux. filed.
Feb 25 2003	Response Requested . (Due March 27, 2003)
May 15 2003	Response to petition from respondent SCS Credit Corporation filed.
Jun 16 2003	Petition GRANTED.
Jul 14 2003	Extension of time within which to file the joint appendix and petitioner's brief on the merits to and including August 21, 2003.
Aug 8 2003	Further extension of time within which to file the joint appendix and petitioner's brief on the merits to and including August 28, 2003.
Aug 11 2003	Joint appendix filed.
Aug 28 2003	Brief amicus curiae of National Association of Chapter Thirteen Trustees filed.
Aug 28 2003	Brief amicus curiae of the United States filed.
Aug 28 2003	Brief amici curiae of National Association of Consumer Bankruptcy Attorneys, et al. filed.
Aug 28 2003	Brief of petitioners Lee M. Till, et ux. filed.
Aug 28 2003	Brief amicus curiae of AARP filed.
Sep 16 2003	Extension of time within which to file respondent's brief on the merits to and including October 24, 2003.
Sep 24 2003	SET FOR ARGUMENT Tuesday, December 2, 2003.
Sep 25 2003	CIRCULATED.
Oct 14 2003	Record received from the U.S. Court of Appeals for the 7th Circuit. (1 box)
Oct 17 2003	Record received from the U.S.D.C. for the Southern District of Indiana. (1 box)
Oct 24 2003	Motion to argue pro hac vice filed by the Solicitor General.
Oct 24 2003	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
Oct 24 2003	Brief amicus curiae of Commercial Lenders filed. (Distributed)
Oct 24 2003	Brief of respondent SCS Credit Corporation filed. (Distributed)
Nov 17 2003	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
Nov 17 2003	Motion to argue pro hac vice filed by the Solicitor General GRANTED.
Nov 24 2003	Reply of petitioners Lee M. Till and Amy M. Till filed. (Distributed)
Dec 2 2003	Argued. For petitioners: Rebecca J. Harper, and on behalf of the United States, as amicus curiae, David B. Salmons, Assistant to the Solicitor General, Department of Justice,

Washington, D.C. For respondent: G. Eric Brunstad, Jr.

(1)

Supreme Court, U.S.
FILED

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No. _____ OFFICE OF THE CLERK

In the Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

a) Is an undersecured creditor entitled to the "indubitable equivalent" of its nonbankruptcy entitlement for purposes of discounting deferred payments to present value under the Chapter 13 cramdown provision at 11 U.S.C. § 1325(a)(5)(B)(ii), resulting in fixing of a subprime lender's 21% contract rate as the presumptive discount rate?

b) What is the proper method for discounting of deferred payments to present value on property retained by the debtor under the Chapter 13 cramdown provision, and what is the creditor entitled to be compensated for in calculating the appropriate discount rate of interest?

PARTIES TO THE PROCEEDING

Petitioners

Petitioners Lee M. Till and Amy M. Till are individual citizens of the United States residing in the Southern District of Indiana. Neither Petitioner has corporate affiliations. Lee M. Till and Amy M. Till were the debtors in the Bankruptcy Court, the Appellees in the District Court and the Appellants in the Seventh Circuit Court of Appeals.

Respondent

Respondent SCS Credit Corporation is a corporation with no parent corporation. Petitioners are unaware of any publicly held company owning ten (10%) percent or more of said corporation's stock. SCS Credit Corporation was the objecting creditor in the Bankruptcy Court, the Appellant in the District Court, and the Appellee in the Seventh Circuit Court of Appeals.

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Petitioners respectfully petition for a Writ of Certiorari to review the opinion of the Seventh Circuit Court of Appeals in this case.

OPINIONS BELOW

The panel opinion of the United States Court of Appeals for the Seventh Circuit (App. B at 3a) was entered on August 21, 2002 and is reported at 301 F.3d 583 (7th Cir. 2002). The Order denying petition for rehearing *en banc* (App. A at 1a) was entered by the Seventh Circuit Court of Appeals on October 10, 2002 and is reported at 2002 U.S. App. LEXIS 21282 (7th Cir. 2002). The unreported opinion of the United States District Court for the Southern District of Indiana (App. C at 34a) was issued on November 1, 2000. The unreported order of the United States Bankruptcy Court for the Southern District of Indiana (App. D at 40a) was issued on June 27, 2000.

STATEMENT OF JURISDICTION

The opinion of the Seventh Circuit Court of Appeals was entered on August 21, 2002. The Court of Appeals entered an order denying a timely petition for rehearing *en banc* on October 10, 2002 (App. A at 1a).

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The operative statutory provision at 11 U.S.C. § 1325(a)(5) provides:[1]

> (a) Except as provided in subsection (b), the court shall confirm a plan if—
>
> * * * *
>
> (5) with respect to each allowed secured claim provided for by the plan—
>
> (A) the holder of such claim has accepted the plan;
>
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
>
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

[1] The critical "value, as of the effective date of the plan" language is commonly used as a term of art in the Bankruptcy Code. *See, e.g.*, 11 U.S.C. §§ 1325(a)(4), 1325(b)(1)(A), 1129(a)(7)(A)(ii), 1129(a)(7)(B), 1129(a)(9)(B)(i), 1129(a)(9)(C), 1129(b)(2)(A)(i)(II), 1129(b)(2)(B)(i), 1129(b)(2)(C)(i), 1225(a)(4), 1225(a)(5)(B)(ii), and 1225(b)(1)(A). These and other statutes are included at App. E to demonstrate the prevalence of the discounting to present value concept throughout the Code, and to illustrate the statutory context of the cramdown provision.

> (C) the debtor surrenders the property securing such claim to such holder; ...

STATEMENT OF THE CASE

Lee M. Till and Amy M. Till filed a petition for relief under Chapter 13, Title 11 of the United States Code on October 25, 1999. The underlying facts are not disputed. SCS Credit Corporation ("SCS") held a perfected security interest in the debtors' 1991 S-10 truck ("vehicle") retained by the debtors for personal use. The amount financed under SCS's original loan dated October 2, 1998 ("contract") was $6,425.00, with a total sale price of $8,385.24 (including interest at the rate of 21% per annum). The "cramdown" value of the vehicle was established by agreement at $4,000.00. The proposed three-year Chapter 13 plan provided for payments by wage assignment to the Trustee in the total amount of $740.00 per month. SCS's allowed secured claim was to be paid in full concurrently with payments on other allowed secured claims, with a discount factor of 9.5% to be paid on the declining balance of the $4,000.00 allowed secured claim from the date of confirmation (App. G at 77a-79a). The 9.5 % discount rate proposed by the debtors was based on a "formula method" (App. D at 43a) consisting of the prime rate as a base, with addition of a 1.5% risk premium ("prime-plus"). SCS objected to confirmation of the plan, arguing that, under the "coerced loan" method, SCS was entitled as a "subprime" lender to its 21% contract rate of interest to compensate for the return on its investment if it were permitted to foreclose on the vehicle and reinvest the proceeds in a like-kind loan (App. D at 41a).

The debtors' expert testified that standard lending institutions use the "prime rate" (national benchmark rate),

which not only accounts for the time-value of money ("a dollar now is a little more valuable that a dollar later"), but which also includes adjustment for the purchasing power of the dollar (the inflation rate), as well as risk and transaction costs. (App. F at 63a-64a).[2] SCS's expert testified that SCS does not sell vehicles on credit for a rate of interest less than 21%, and that 21% was the rate charged by other similar lenders in the area. (App. F at 73a). The Trustee recommended a formula method previously adopted by the courts in that district. (App. F at 60a-62a).

The Bankruptcy Court rejected the notion that the discount factor should be tied to the creditor's subprime lending status, and interpreted *Koopmans v. Farm Credit Services of Mid-America*, ACA, 102 F.3d 874 (7th Cir. 1996), to afford the court discretion to adopt the prime-plus 1.5% rate ultimately approved by the court. The matter before the Bankruptcy Court was a core proceeding within the meaning of 28 U.S.C. § 157(b)(2)(L). Exercising jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1) and 1334, the Bankruptcy Court confirmed the amended Chapter 13 plan (App. D at 42a-43a).

SCS timely appealed the final order approving confirmation of the plan to the United States District Court for

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[2] This testimony is consistent with the common fact that the prime rate already includes a risk-cost premium to reflect the inherent risk in loans. Matthew Y. Harris, "Chapter 13 Cramdown Interest Rates: Another Day, Another Dollar--A Cry for Help in Ending the Quest for the Appropriate Rate," 67 Miss. L.J. 567, 581-82 (1997). It is for that reason that many courts and commentators prefer use of risk-free rates based on government securities, to which a risk premium may be added by the court. C. Frank Carbiener, "Present Value in Bankruptcy: The Search for an Appropriate Cramdown Discount Rate," 32 S.D.L.Rev. 42, 60-65 (1997).

the Southern District of Indiana, Indianapolis Division, which exercised jurisdiction pursuant to 28 U.S.C. §§ 158(a) and 1334. The District Court reversed the Bankruptcy Court on the basis that unrebutted evidence established that a "subprime" market existed and that the established rate for the subprime lending market was 21%, which the District Court considered the controlling inquiry under *Koopmans* (App. C at 38a). Under the District Court's ruling, the Bankruptcy Court erred as a matter of law and had no discretion to adopt the "prime plus" discount rate.

The debtors appealed the District Court decision to the Seventh Circuit. The majority panel of judges assigned to the case[3] interpreted *Koopmans* to mandate a "coerced loan" approach. Conceptualizing the cramdown process as forcing the creditor to extend a new line of credit to the debtor, the majority panel reasoned that "the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk," since nothing less would give the creditor the "indubitable equivalent" of its nonbankruptcy entitlement (App. B at 17a-18a). Adopting *GMAC v. Jones*, 999 F.2d 63 (3d Cir. 1993), the majority panel concluded that the "old contract rate will yield a rate sufficiently reflective of the value of the collateral at the time of the effectiveness of the plan to serve as a presumptive rate." (App. B at 20a).[4]

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[3] The panel decision was divided, with Judge Rovner (who had sat on the panel in *Koopmans*) issuing a rigorous 10-page dissent.

[4] The majority's non sequitur that the 21% contract rate is a "rate" presumptively "reflective of the value of the vehicle" at confirmation again demonstrates the majority's misapprehension of the purpose of the present value inquiry.

Tills timely petitioned for rehearing *en banc,* which was denied on October 10, 2002.

REASONS FOR GRANTING THE PETITION

Few other issues under the Bankruptcy Code have generated so many conflicting decisions and, in the words of the majority panel below, caused such "significant disagreement among the courts of appeals, bankruptcy courts and commentators." (App. B at 10a). The important federal question at issue is the standard to be applied in discounting deferred payments to "present value" under a Chapter 13 cramdown. Ten Circuits have now "become embroiled in the interest rate controversy," with each new decision "driving yet another wedge between the already split circuits." Matthew Y. Harris, "Chapter 13 Cram Down Interest Rates: Another Day, Another Dollar -- A Cry For Help in Ending the Quest for the Appropriate Rate," 67 Miss. L.J. 567, 568 (1997).

Disposition of the issue presented in this case can be expected to have a profound economic impact on bankruptcy jurisprudence nationwide. The legislature has expressed a clear intent to encourage filing of Chapter 13 reorganizations over Chapter 7 liquidations. H.R. Rep. No. 95-595, 95th Cong. 2d Sess.118, 129, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6080, 6090. The impetus Congress intended for Chapter 13 is not yet reflected in the numbers. In 2001, 1,054,618 Chapter 7s were filed nationwide as compared to only 425,213 Chapter 13 filings. "Current Bankruptcy Statistics," http://www.abiworld.org/stats/currentstats.html. It is estimated that, like the debtors in the case below, nearly 60% of U.S. adults have "subprime" credit. "Sub Prime" Lending, 1998, 1999 New Media Auto Services, Inc., http://www.carinvoices.com/financing/about_financing/sub_prime_credit.htm. Analysts agree that "subprime" loans are "extremely profitable" for creditors,[5] Evan M. Gilreath, "The Entrance of Banks Into Subprime Lending: First Union and The Money Store," 3 N.C.Banking Inst. 149, n.18 (1999), resulting in great potential for abuse.

It is a fundamental purpose of Chapter 13 to provide all debtors with an effective means of retaining property and dealing with secured creditors. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 124 (1977) *reprinted in* Vol. C, *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender 15th ed. rev.). Yet few could disagree that financially-stressed debtors paying 21% interest under a Chapter 13 plan are *not* effectively dealing with their secured creditors — as the legislature intended. Most Chapter 13 plans are tightly budgeted, and reinstatement of the contractual interest rate will remove Chapter 13 as an option for many debtors based solely on their location of residence. [6] Under the same federal statute,

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[5] Subprime lending often involves financially unsophisticated borrowers desperate for credit who agree to unjustified high interest payments they cannot afford. Cathy Lesser Mansfield, "The Road to Subprime 'HEL' Was Paved With Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market, 51 S.C.L. Rev. 473 (2000).

[6] Payment of an allowed secured claim in an amount of $15,000.00 at 9.5 % interest (the rate adopted by the Bankruptcy Court in the case below) over the maximum five-year plan term requires base funding in an amount of approx. $18,753.00 @ $312.55/month, whereas payment of $15,000.00 at 21 % interest over the same period requires base funding of $23,929.20 @ $398.82/month -- a staggering $5,176.20 increase in interest exclusive of the additional trustee fees generated thereon.

debtors in Indiana may be required to pay the contract rate of 21% or more, whereas debtors in a district applying a formula method may pay 7% -- contrary to the uniform application intended by Congress -- and perhaps the best evidence of misapplication of the present value concept which, if properly applied, could never produce such widely divergent results.

Nor do the implications of the lower court's ruling stop at 11 U.S.C. § 1325(a)(5)(B)(ii). The "value, as of the effective date of the plan" language appears in a variety of contexts throughout the reorganization chapters. Congress has expressed an intent that this language be read consistently to require discounting to present value wherever the term is used. Dean Pawlowic, "Entitlement to Interest Under the Bankruptcy Code, 12 Bankr. Dev. J. 149, 168-69 (1995). The absence of uniform standards has made the discount rate calculation "the most discussed and debated issue in Chapter 12 confirmation cases," where the present value language parallels that of Chapter 13. Scott L. Sanders, "Plan Confirmation Under Section 1225 of the Bankruptcy Code: Sowing the Seeds of Inconsistency," 8 Bankr. Dev. J. 291, 310 (1991).

The critical need for direction from this Court is evidenced on a daily basis in the form of protracted litigation depleting the limited time and resources of bankruptcy courts across the country. Matthew Y. Harris, "Chapter 13 Cram Down Interest Rates: Another Day, Another Dollar -- A Cry For Help in Ending the Quest for the Appropriate Rate," 67 Miss. L.J. 567, 583 (1997).

I. The Decision of the Seventh Circuit Court of Appeals Conflicts With the Decisions of Other Circuits

The majority panel's holding is squarely contrary to the decisions of the Second, Eighth and Ninth Circuit Courts of Appeals, all of which have adopted a "formula" method for computing the cramdown rate of interest. Under the "formula" method, the court adopts a readily-accessible or national risk-free rate as a base and adds a risk premium corresponding to the court's determination of the risk associated with the reorganization plan.

The Eighth Circuit in *United States v. Doud*, 869 F. 2d 1144, 1146 (8th Cir. 1989), was the first of the Circuits to approve a bankruptcy court's use of a "formula" approach in determining Chapter 12 cramdown interest (treasury bond plus 2% risk premium). The Ninth Circuit in *In re Fowler*, 903 F. 2d 694, 698 (9th Cir. 1990), concluded that the bankruptcy court had correctly adopted a "formula" approach (prime rate) for Chapter 12 cramdown, and remanded the case to the bankruptcy court for determination of an appropriate risk factor. The Second Circuit in *In re Valenti*, 105 F. 3d 55, 63 (2d Cir. 1997) [*modified on other grounds by Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997)], ruled that Chapter 13 cramdown interest should be fixed at the treasury bond rate plus a 1-3% risk premium.

II. The "Coerced Loan" Method is Fundamentally Flawed

Several other Circuits have applied variations of the "coerced loan" method adopted by the majority panel below. *Matter of Southern States Motor Inns, Inc.*, 709 F. 2d 647 (11th Cir. 1983), *cert.den*, 465 U.S. 1022 (1984); *United States v. Arnold*, 878 F. 2d 925 (6th Cir. 1989); *In re*

Hardzog, 901 F. 2d 858 (10th Cir. 1990); *United Carolina Bank v. Hall*, 993 F. 2d 1126 (4th Cir. 1993); *GMAC v. Jones*, 999 F. 2d 63 (3d Cir. 1993); and *In re Smithwick*, 121 F. 3d 211 (5th Cir. 1997), *cert. den.* 523 U.S. 1074 (1998). Yet even these Circuits cannot reach consensus. Whereas the Fourth Circuit in *United Carolina Bank*, 993 F. 2d at 1131, caps the discount rate at the contract amount, *GMAC v. Jones*, 999 F.2d at 70-71, and the majority panel below (App. B at 21a) recognize no such limit.

Petitioners contend that these cases are premised upon a series of errors that caused these Courts, like the majority below, to misapprehend the limited purpose of the present value calculation.

A. Improper Expansion of Plain Language of Statute

The majority panel begins with the premise that it is "reasonable to presume" what Congress intended under § 1325(a)(5) (App. B at 11a), and concludes that, "to exclude the element of profit from the fixing of the market rate would violate the statutory directive" that the creditor be placed in the same position that it would have been in had it been permitted to repossess the collateral (App. B at 19a). Remarkably, this so-called "statutory directive" appears nowhere in the statute.

The operative language of the Code is "value, as of the effective date of the plan" at 11 U.S.C. § 1325(a)(5)(B)(ii).

By the time the Bankruptcy Code was enacted, "present value" or the "time value of money" was recognized as a "term of art" in the financial community, meaning that a dollar received today is worth more than a dollar to be received in the future. Thus, a "discount rate" of interest is

applied to a stream of payments to ensure that the creditor will receive the same amount of money in the future that it would have received if there had been no delay in payment. E. Grant & W. Ireson, Principles of Engineering Economy 40 (4th ed. 1964). The "discount rate" is universally understood to consist of two components: 1) a riskless rate to account for the time value of money, and 2) an adjustment to account for risk. Richard A. Brealey and Steward C. Myers, Principles of Corporate Finance, p. 244 (6th Cir. 2000).

Against this backdrop, "[a]lthough the Code itself offers no definition of ... present value in this context, the legislative history describes the mechanical process of determining present value in a manner consistent with the use of the term by the economic and financial community." Dean Pawlowic, "Entitlement to Interest Under the Bankruptcy Code," 12 Bank. Dev. J. 149, 169 (1995). H.R. Rep. No. 95-595, U.S. Code Cong. & Admin. News 1978, p.6464 as appearing in 2 Appendix *Collier on Bankruptcy* at 408; H.R. Rep. No. 95-595, 95th Cong., 1st Sess., 414-15 (1977).

This Court in *Case v. Los Angeles Lumber Products Co., LTD.*, 308 U.S. 106, 115 (1939) adhered to the familiar rule of construction that "where words are employed in an act which had at the time a well known meaning ..., they are used in that sense...." The transformation of the historic present value concept into the creditor-specific inquiry undertaken by the majority could not occur without the specific intent of Congress clearly expressed in the statute, *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986), and the language of the cramdown statute conveys no such intent.

It follows that a "plain language" interpretation of the statute suggests "a simple payment stream discounted to

reflect the time value of money in the current economy without any additional fact-based considerations." Michael E.S. Frankel, "The Emerging Fixed Cramdown Rate Regime: A Market-Driven Argument for Effective Fixed Rates in Bankruptcy Cramdown," 2 U. Chi. L. Sch. Roundtable 643 n. 75 (1995). It is the sole purpose of the discount to preserve the present value of a "claim" in a fixed amount--not to restore the creditor's entitlement under its pre-petition "loan."

These concepts are so well-accepted that the court in *In re Oaks Partners, LTD*, 135 B.R. 440, 445 (Bankr. N.D. Ga. 1991) noted that, because of the mechanical nature of the "present value" calculation, the *"time value of money"* approach is commonly referred to as the *"formula"* approach.

B. Misapplication of Legislative History

Congress has consistently described the obligation to pay "plan" or "present value" interest in very different terms than the obligation to pay pre-confirmation or "pendency" interest.[7] Despite the absence of any requirement for payment of "contractual" interest at § 1325(a)(5)(B)(ii), courts rejecting the formula method frequently conclude that there exists a "presumption" for the contract rate under § 1325(a)(5)(B)(ii).

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[7] Cf. 11 U.S.C. § 506(b) (App. E at 46a), where the Code refers to pre-confirmation "interest" on oversecured claims, and certain other charges "provided for under the agreement," and 11 U.S.C. § 726(a)(5) (App. E at 47a), where the Code refers to payment of "interest at the legal rate."

In the preeminent "coerced loan" case adopted by the majority below, the Court in *GMAC v. Jones*, *supra*, explained the presumption in favor of the contract rate as follows:

> There is, in the legislative history,...support for the idea that the contract rate is to be accorded...privileged significance when determining the appropriate interest rate. In the discussion of § 502(b).., the drafters noted that 'bankruptcy operates as the acceleration of the principal amount of all claims against the debtor. One unarticulated reason for this is that the *discounting factor for claims after the commencement of the case is equivalent to contractual interest rate on the claim.'* Bankruptcy Reform Act of 1978, P.L. 95-598, 1978 U.S. Code Cong.& Admin.News, 5849 (emphasis added).

999 F.2d at 70, n. 10.

The earliest "contract presumption" cases concluded from the above legislative history that "[o]f course, there is a presumption that the discount rate and the rate set forth in the contract are equivalent." *Matter of Smith*, 4 B.R. 12 (Bankr. E.D. N.Y. 1980); *Accord*, *Matter of Rogers*, 6 B.R. 472, 475 (Bankr. S.D. Ia. 1980)[noting that "Congress has suggested that there should be a presumption that a proper discount rate would be the same as the rate set out in the parties' interest bearing agreement"].

So it turns out that *GMAC v. Jones,* expressly adopted by the majority panel, had a pre-existing bias for the contract rate based upon misreference to legislative history of §

502(b). One commentator characterized this common misuse of the legislative history as follows:

> ...Congress pointed out section 502 required that ... any claim for unmatured interest be disallowed. [ ] The Reports also state that creditors' claims for amounts owing after the petition is filed must be discounted at a rate equal to the contract interest rate. [ ] In fact, the Reports went so far as to state that when discounting such claims, there is an 'irrebuttable presumption that the discount rate and the contractual interest rate (even a zero interest rate) are equivalent.' [ ] This language, however, has no relevance to the cramdown discount rate under sections 1129 and 1325.... And nowhere in the legislative history of sections 1129 or 1325 did Congress state that the deferred payment discount rate, which compensates for the time value of money, is equal to the contract rate.

C. Frank Carbiener, "Present Value in Bankruptcy: the Search for an Appropriate Cramdown Discount Rate," 32 S.D. L. Rev. 42 (1987) (citations omitted).

The fact that Congress considered but deliberately chose *not* to equate the present value discount rate to the contract rate is apparent from a review of the legislative process leading to the Bankruptcy Amendment and Federal Judgeship Act of 1984, where Congress specifically considered an amendment requiring the contract rate of interest to be paid under § 1325(a)(5)(B)(ii) and rejected it. H.R. 1085, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 1169, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 4786, 97th

Cong. § 19(2)(A) (1981).

C. Reliance Upon Unsupported and Conflicting Excerpts from Collier Treatise

The legislative history of § 502 is not the only false start that gave root to the "coerced loan" theory adopted by the panel majority.

Much of the confusion that has surrounded the § 1325(a)(5)(B)(ii) present value concept was generated by an editor's comment in the Collier Bankruptcy treatise, where it was submitted in the context of ascertaining present value for purposes of 11 U.S.C. § 1129(a)(9)(C), that "deferred payment" of an obligation under a plan is a "coerced loan" for which the creditor must receive a "market rate" of interest corresponding to the rate the creditor would charge to a third party in a like-kind loan. 4 Collier on Bankruptcy, ¶ 1129.03, at 1129-62, 63 (15th ed. 1987).

As described by the court in *In re Computer Optics, Inc.*, 126 B.R. 664, 671 (Bank. D.N.H. 1991), "without citing any ... authority ..., the Collier treatise took a 'quantum leap' from the present value concept (...time value of money) into a totally different concept of a loan transaction" involving a fact-specific inquiry that has "skewed the analysis ever since."

Ironically, when addressing the appropriate discount rate for purposes of *Chapter 13 cramdown*, the above Collier treatise adopted the "cost of funds" approach (App. B at 13a-15a), whereby the discount rate is set at the rate the creditor would have to pay to borrow the amount equal to the allowed secured claim. In harshly criticizing courts' attempts to apply the contract rate for the present value calculation under §

1325(a)(5)(B)(ii) despite the legislature's express rejection of the contract rate, the Collier treatise stated as follows:

> Thus, *contrary to the holdings of a number of courts, it is rarely appropriate to select the rate charged to the debtor in the original transaction as the present value discount rate*. Treating the chapter 13 deferral of payments like a new loan transaction, as those courts have done, provides the holder of the allowed secured claim with not only the cost of the funds it would lend but also the costs of the new loan transaction, which would not be incurred, and the profit that would be earned in that transaction. Neither of these latter two amounts would be received if the collateral were surrendered; .... To include them in the present value discount rate would give the holder of an allowed secured claim more than the equivalent of immediate payment of that claim in full.

5 Collier on Bankruptcy ¶ 1325.06, at 1325-37, 38 (15th ed. 1987) (emphasis added).[8]

[8] Ironically, the higher the original contract interest rate, the higher the costs saved by the creditor in bankruptcy. C. Frank Carbiener, "Present Value in Bankruptcy: The Search for An Appropriate Cramdown Discount Rate, 32 S.D.L. Rev. 42, 56 (1987), pp. 56-65.

D. Improper Invocation of *Murel* "Indubitable Equivalent" Doctrine

The final major source of "authority" for advocates of the "coerced loan" theory is the case of *In re Murel Holding Corp.*, 75 F. 2d 941 (2d Cir. 1935), which arose under the Bankruptcy Act of 1898 and introduced the concept of "indubitable equivalence."[9]

In *Murel*, the secured creditor held a mortgage on an apartment house. After the debtors defaulted on the mortgage, the creditor attempted to foreclose. The debtors obtained a stay of foreclosure and proposed a plan of reorganization to pay the creditor interest over 10 years, with full payment of the principal due at the end of the 10-year period, and no payment on principal or substitution of collateral in the interim. On appeal, the creditor complained that its interests were not "adequately protected." Judge Hand anticipated rejection of this "wholly speculative" plan, since the creditor would receive neither the principal, the

[9] The "indubitable equivalence" standard was never codified under Chapter 13, but was instead codified at § 1129(b). As an alternative to the Chapter 11 debtor's payment of "present value" as of the effective date of the plan under § 1129(b)(2)(A)(i)(II), the debtor can instead provide the "indubitable equivalent" of the creditor's secured claim under § 1129(b)(2)(A)(iii). The legislative history states that abandonment of the collateral to the class would satisfy this "indubitable equivalent" standard, as would a replacement lien on similar collateral. 124 *Cong. Rec.* H. 11,103, 11,104 (daily ed. Sept. 28, 1978) (remarks of Rep. Don Edwards); 124 *Cong. Rec.* S. 17,420, 17,421 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini). The inapplicability of the "indubitable equivalent" concept to deferred payments under Chapter 13 cramdown is readily apparent.

property, nor an equivalent substitute for a period of 10 years. The Court thus found that treatment of the secured claim was insufficient to justify a stay of foreclosure. 75 F.2d at 942.

Misapplication of the *Murel* decision played a most decisive role in the erroneous conclusion ultimately reached by the majority below. The majority panel concluded that its application of the coerced loan approach was mandated by the Seventh Circuit decision of *Koopmans v. Farm Credit Serv. of Mid-America, ACA*, 102 F.3d 874 (7th Cir. 1996). *Koopmans* construed *Murel* as controlling precedent on the "rate of interest" that a secured creditor is to receive under a Chapter 12 cramdown. According to *Koopmans*, *Murel* mandated that a creditor in cramdown receive compensation for the "indubitable equivalence" of its property interest, which could only be achieved by the fixing of a market rate of interest that will make the creditor as well off in the reorganization as if the creditor had been permitted to foreclose its collateral and reinvest the proceeds in loans of equivalent duration and risk. 102 F.2d at 874-875. The panel majority read *Koopmans* and *Murel* together to compel a "coerced loan" approach whereby the creditor realizes the "indubitable equivalent" of its nonbankruptcy entitlement (App. B at 17a).[10] The fact that the cramdown statute did not even exist at the time of the *Murel* decision shows that the *majority panel would have reached precisely the same result*

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[10] In the dissent below, Judge Rovner noted that *Koopmans* has been interpreted as endorsing the formula, coerced loan and cost of funds approach, and can be best described as not requiring bankruptcy courts to use any particular approach (App. B at 31a). The Seventh Circuit in *Koopmans* expressly noted that it was not even "implying [that the method used by the bankruptcy court] is the only way to approximate the market rate of interest...." 102 F.3d at 875.

without the cramdown statute. The cramdown statute was unnecessary to the majority's analysis, and simply played no part in the outcome.

The precedential value placed upon *Murel* in the § 1325(a)(5)(B)(ii) context had been widely criticized, until it was finally dispelled by the *Murel* analysis undertaken by this Court in *United States Ass'n v. Timbers of Inwood Forest Assocs., LTD.*, 484 U.S. 365 (1988). This Court in *Timbers* made the critical distinction that Judge Hand in *Murel* used the words "indubitable equivalence" not with reference to **"interest"** (as it was interpreted by the Seventh Circuit in *Koopmans* and by the majority panel below), but rather "with specific reference to the **jeopardized principal** of its loan" (emphasis added). As explained by this Court in *Timbers*, whereas "interest" was assured under the plan in *Murel*, the plan made no provision for amortization of principal or maintenance of the collateral's value during the 10-year term. 484 U.S. at 378. *Murel* did not even involve the distribution of periodic deferred payments on principal -- the typical mode of payment under a Chapter 13 plan. Since the plan at issue in the present case provided for full payment of SCS's allowed secured claim (principal) with interest within the three-year plan term (App. G at 77a-78a), there was no "jeopardized principal" issue in the case below.[11] As noted by this Court in *Timbers*, *Murel* did proceed on the premise that the secured creditor is entitled to present value in the confirmation context, but the necessity for showing something more ("indubitable equivalence") in *Murel* resulted from the

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[11] It has been noted that even *Murel* would have permitted payment of the allowed value of the secured creditor's lien. Theodore Eisenberg, "The Undersecured Creditor in Reorganizations and the Nature of the Security," 38 Vand. L. Rev. 931,954 (1985).

plan's lack of proper provision for payment of the principal--*not from use of an insufficent present value discount rate*. 484 U.S. at 378. Contrary to the holdings of *Koopmans* and the majority below, *Murel* does *not* stand for the proposition that "indubitable equivalence" is to be used as a standard for calculating the cramdown interest rate. The central premise upon which the panel majority's decision was based -- that discounting to present value requires the undersecured creditor to receive the "indubitable equivalent" of its nonbankruptcy entitlement and be placed in as good a position as it would have been had it been entitled to foreclose its collateral and reinvest the proceeds -- derives not from the cramdown statute, but from a misapplication of the *Murel* doctrine -- and nothing more.

III. THE DECISION OF THE SEVENTH CIRCUIT COURT OF APPEALS CONFLICTS WITH THE DECISIONS OF THIS COURT

Although this Court has never addressed the precise issue presented in this case, the reasoning of several key decisions of this Court is contrary to the conclusion of the panel majority.

Pursuant to 11 U.S.C. § 1322(b)(2), Chapter 13 debtors can modify the rights of secured creditors such as SCS. This Court in *Nobleman v. American Savings Bank*, 508 U.S. 324, 329 (1993) determined that the "rights" implicated by § 1322(b)(2) are *those rights provided by state law*. One such "right" identified by *Nobelman* is the *contractual interest rate*. *Nobleman* established that a creditor's state-law property rights are recognized in bankruptcy *only* in the absence of controlling federal law. Chapter 13 "cramdown" by definition does not require creditor consent. *In re Milham*, 141 F. 3d 420, 425 (2d Cir.

1998), *cert. den.*, 525 U.S. 872 (1998). The "very essence" of § 1325(a)(5)(B)(ii) is *contract modification*. *In re Paschen*, 296 F.3d 1203 (11th Cir. 2002) (*pet. cert.* 10/8/02).

This Court in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), held that secured property retained by the debtor over the creditor's objection under § 1325(a)(5)(B)(ii) is to be valued at its present replacement value, based upon the § 506(a) mandate that value is to be determined in light of the proposed disposition of the property. This Court in *Rash* noted that the debtor under § 1325(a)(5)(B)(ii) is required to provide the creditor with payments, over the life of the plan, that will total the "present value" of the "allowed secured claim," i.e., the "present value of the collateral ...." 520 U.S. at 953. Although this Court in *Rash* did not address the method for computing present value, because *Rash* also centered on the "cramdown" provision, the lessons of *Rash* are many.

In *Rash*, this Court made clear that, by allowing Chapter 13 debtors to retain collateral over the secured creditor's objection, the Bankruptcy Code deliberately "reshaped debtor and creditor rights in a marked departure from state law." Further, the "Code's cram down option displaces a secured creditor's state-law right to obtain immediate foreclosure upon a debtor's default." Because this Court in *Rash* recognized the cramdown provision as "controlling federal law," this Court, unlike the majority panel below, easily rejected the argument that the creditor should be placed in the same economic position that it would have been had it exercised its state-court foreclosure rights. Under *Rash*, a creditor's "interest in property" is valued independent of its right to immediate possession of the collateral on default.

The *Rash* decision has several implications at odds with the "coerced loan" approach adopted by *GMAC v. Jones* and the majority panel. As noted by the Court in *In re Segura*, 218 B.R. 166 (Bankr. N.D. Ok. 1998):

> The *Jones* theory ... has at its core the assumption that the creditor would reinvest the *proceeds of liquidated collateral*. *Rash*, however, requires that the present value of the sum representing the replacement value of the collateral, rather than the liquidation value, be paid out over the life of the chapter 13 plan. *Id*. Since *Rash*, the *Jones* rationale rests upon a faulty premise and is unfairly advantageous to the creditor.

In re Segura, 218 B.R. 166, 173-74 (Bankr. N.D. Ok. 1998).

This Court in *Rash* noted that "[a]djustments in the interest rate do not fully offset" the "risks" of debtor default and property deterioration incurred by the creditor when the debtor retains the collateral, whereas "the replacement-value standard accurately gauges these additional risks." 520 U.S. at 158. The court in *In re Goodyear*, 218 B.R. 718, 721 (Bankr. D. Vt. 1998) thus noted that *Rash* shifted compensation for the risk of default from the "interest" component to the "valuation" component, and concluded that, "[i]f the risks ... occasioned by a debtor's retention and use of the collateral are 'accurately gauged' in the valuation process, then there is no occasion to provide additional compensation for the same risk in determining the appropriate interest

rate."[12]

The case of *United States Ass'n of Texas v. Timbers of Inwood Forest Assocs., LTD.*, 484 U.S. 365, 372 (1988) involved an undersecured creditor's request for pre-confirmation adequate protection payments pursuant to 11 U.S.C. § 362(d)(1) to result in realization of the "indubitable equivalent" of the creditor's interest in property under 11 U.S.C. § 361(3). This Court in *Timbers* determined that a creditor's "interest in property" means its security interest (value of collateral or allowed secured claim) without taking into account the creditor's state-law right to immediate possession of the collateral on default or lost opportunity costs resulting from the creditor's inability to liquidate the collateral pending confirmation of a Chapter 11 plan.

Distilled to its barest essence, the "coerced loan" theory adopted by the majority panel is an argument for compensating the creditor for "lost opportunity costs" which result when the creditor is denied the ability to immediately liquidate the collateral and reinvest the proceeds. *In re Collins*, 167 B.R. 842, 845-46 (Bankr. E. D. Tx. 1994). Under the language of the cramdown statute, the creditor is to be compensated *only* for the *fixed amount of the allowed secured claim* (an amount strictly limited to the value of the property securing the debt). As a result of the *Timbers'* strict adherence to the terms of the statute in defining the

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[12] In the dissent below, Judge Rovner concluded that by requiring the debtor to pay the creditor the (higher) replacement cost of the vehicle, "the Supreme Court has already ensured that the creditor will be afforded significant compensation for the risk of non-payment." (App. B at 30a.) All other Circuit decisions adopting the "coerced loan" approach, with the exception of the decision in *Smithwick*, 121 F.3d 211 (5th Cir. 1997), pre-dated the *Rash* decision.

undersecured creditor's property interest which must be adequately protected, *Timbers* has been read to remove the elements of profit and lost opportunity costs from the present value calculation.[13] Hon. John K. Pearson, "Ending the Judicial Snipe Hunt: The Search for the Cramdown Interest Rate," 4 Am. Bankr. Inst. L. Rev. 35, 52 (1996).

The *Timbers* analysis is also considered significant because "present value" under § 1325(a)(5)(B)(ii), much like adequate protection under § 362(d)(1), attempts to remedy the loss in value of money due solely to the passage of time (i.e., both serve to protect the status quo). *Timbers* rejected the notion that undersecured creditors should receive interest to compensate for lost opportunity costs before unsecured creditors had recovered any principal. 484 U.S. at 373.

This Court in *Timbers* concluded that only one meaning of "interest in property" produced a substantive effect compatible with the rest of the law without rendering portions of the statute a nullity. 484 U.S. at 371.

Similarly, in the present case, to reinstate the contract rate as the presumptive rate under § 1325(a)(5)(B)(ii) is, in the words of this Court, "to destroy the law under the pretext of enforcing it." *Earle v. Carson*, 188 U.S. 42, 47 (1903). By attempting to derive the interest rate without regard for the statutory framework of the cramdown provision, the majority panel has destroyed one of the most important contract modification rights afforded the debtor at § 1325(a)(5)(B)(ii).

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[13] Contrast the list of factors for which SCS was compensated by the panel majority, including profit (App. B at 19a), as well as compensation for depreciation in value of collateral and the creditor's cost of continuing to service the loan (App. B at 16a).

Critics of the "coerced loan" method also caution that the secured creditor could present expert testimony that no lender would make a loan which is compatible to the creditor's treatment under the proposed plan, only to propose an extreme rate of interest that a lender would require if it were to make such a loan, thus rendering the cramdown provision a "nullity." *In re River Village Assocs.*, 161 B.R. 127 (Bankr. E.D. Pa. 1993), *aff'd*, 181 B.R. 795 (E.D. Pa. 1995).

The "coerced loan" approach upsets the symmetry of the Code in other critical respects. 11 U.S.C. § 506(b) allows an oversecured creditor to add interest that accumulates prior to confirmation to the secured claim awaiting distribution under the debtor's plan. The post-petition interest under § 506(b) becomes part of the secured claim and may accrue until the effective date of the plan. Upon confirmation, § 1325(a)(5)(B)(ii) requires that payments made under the plan return the "present value" of the § 506(b) secured claim amount to the creditor. In the case of an oversecured creditor, §§ 506(b) and 1325(a)(5)(B)(ii) compliment each other and together ensure the full payment of the present value of the secured creditor's claim. *In re Harko*, 211 B.R. 116, 123 (2d Cir. BAP 1997), *aff'd*, 141 F. 3d 420 (2d Cir. 1998), *cert.den.*, 525 U.S. 872 (1998). As a result of the reference to the "agreement under which such claim arose" at § 506(b), the contract rate of interest has been recognized as a presumptive rate of interest under § 506(b). *In re Harko, supra*, 211 B.R. at 119. The substitution of a contract rate of interest for "present value" interest under § 1325(a)(5)(B)(ii) ignores the different objectives underlying the selection of the interest rates under these two sections. The Court in *In re Young*, 61 B.R. 150, 151-54 (Bankr. S.D. Ind. 1986) cited the case of *Matter of Burgess Wholesale Mfg. Opticians, Inc.*, 721 F.2d 1146 (7th Cir. 1983) as Seventh Circuit precedent to

distinguish statutory "present value" interest payments under § 1325(a)(4) and contractual interest under § 506(b).[14]

The majority panel's decision also redistributes rights between debtors and creditors contrary to the statutory scheme. The majority below adopted the holding of the Third Circuit in *GMAC v. Jones, supra*, 999 F. 2d 63, wherein the Court states as follows:

> Conversely, utilizing the same rebuttable presumption approach, if a debtor proposes a plan with a rate less than the contract rate, it would be appropriate, in the absence of a stipulation, for a *bankruptcy court to require the debtor to come forward with some evidence* that the creditor's current rate is less than the contract rate.

999 F. 2d at 70-71 (emphasis added).

Under 11 U.S.C. § 1325(a), the court "shall" confirm the plan if certain minimal requirements for confirmation are met. Under § 1325(a)(5)(A), the debtor need not satisfy § 1325(a)(5)(B) if the creditor fails to object to the plan. Requiring the debtor to "come forward with evidence" to support any below-contract interest rate renders § 1325(a)(5)(A) a nullity, and necessitates the setting of evidentiary hearings in Chapter 13 cases that, prior to the panel decision below, would have been routinely confirmed.

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[14] In their Petition for Rehearing *En Banc*, Petitioners asserted that the ruling of the majority panel below conflicted with the Seventh Circuit's earlier characterization of the "present value" calculation in *Burgess, supra*.

It is a well-recognized canon of construction that words repeated within the same statutory section have an identical meaning in the several places employed. *George Van Camp & Sons Co. v. American Can Co.*, 278 U.S. 245 (1929). The "value, as of the effective date of the plan" language appears throughout the reorganization chapters (App. E at 48a-54a), and has consistently been interpreted under a "present value" analysis to require that payments be adjusted "to allow for the changing value of a dollar". *See*, e.g., *United States v. Neal Pharmacal Co.*, 789 F. 2d 1283 (8th Cir. 1986) [method for determining proper discount rate is same under § 1129(a)(9)(C) for unsecured tax claims as § 1129(a)(7) for secured cramdown); *Accord*, *Matter of Burgess Wholesale Mfg. Opticians, Inc.* 721 F. 2d 1146, 1147 (7th Cir. 1983). In sharp contrast, under the majority panel's ruling, every unsecured claimant would be entitled to a different interest rate based on its contract or lending market when a debtor must pay "value, as of the effective date of the plan" to unsecured claimants to satisfy the best-interests-of-creditors test under § 1325(a)(4). Lundin, 2 Chapter 13 Bankruptcy § 112.1 at 112-8 (3d. ed. 2000).

Although this Court has never considered the appropriate discount rate in the context of the Bankruptcy Code, this Court has previously examined discounting to present value in other contexts. In *Commissioner of Internal Revenue* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134,150 (1974), this Court described the economics underlying "discount" to adjust for the difference between the interest prescribed in the *instrument* issued and the prevailing *market rate* for money, in much the same way the market rate concept was originally intended under the Code to distinguish "present value" plan interest from contract or pendency interest.

In the context of discounting lost future earnings to present value, this Court in *Jones & Laughlin Steel Corp. v. Pfeifer,* 462 U.S. 523, 537 (1983) concluded that the discount rate should be based on the rate of interest that would be earned on the "best and safest investments," and noted that the arithmetic necessary for discounting may be simplified through use of present value tables standard in the financial community. 462 U.S. at 537. This Court in *Pfeifer* concluded that federal law applied in determining the method for discounting to present value where the cause of action was rooted in federal maritime law. 462 U.S. at 547. Although these nonbankruptcy cases did not adopt an exclusive federal rule (for discounting award of future damages to present value), these cases applied terms employed by the financial and economic community to describe the limited function of the present value concept and to establish guidelines as to what factors could be considered and what losses must be excluded from the discounting process. To now redefine the present value concept in the bankruptcy context in the manner prescribed by the panel majority would be historically unprecedented.

IV. THE ISSUE HERE PRESENTED IS OF SUBSTANTIAL IMPORTANCE

The interest rate to be paid by debtors on claims existing at the time of reorganization is arguably "the most debated economic issue in bankruptcy litigation." Monica Hartman, "Selecting the Correct Cramdown Interest Rate in Chapter 11 and Chapter 13 Bankruptcies," 47 U.C.L.A. L. Rev. 521,522 (1999). Courts and commentators agree that the serious financial impact of the interest rate determination has made this issue the single-most contested issue in plan confirmation.

The decision of the panel majority requires that the creditor receive indubitable equivalence and lost opportunity costs rejected by this Court as part of the creditor's allowed secured claim, renders the § 1322 contract modification provision a nullity, and is patently unworkable within the statutory scheme of which § 1325(a)(5)(B)(ii) is a part.

The impact of the majority decision on the typical debtor can be devastating. The majority adopts rigid standards for confirmation in violation of the § 1325(a) mandate that the plan be confirmed if the minimal statutory requirements are met. Given the gross disparity between resources of debtors and creditors, overreaching creditors stand to profit immensely at the expense of unsecured creditors and the typical Chapter 13 debtor struggling to protect a family's most basic necessities.

Given the prevalence of the issue throughout the Code, the decision of the panel majority below can be expected to have unintended and irreversible consequences in all bankruptcy reorganization cases. Nor will the impact of the majority decision be remedied by bankruptcy reform, because the fundamental concept of discounting to present value will remain an historically central feature of the reorganization chapters. Given the sharp division amongst the Circuits and the urgent need for uniform standards, only a decision of this Court can address a problem of such national import.

CONCLUSION

Petitioners contend that numerous Circuits have applied the present value discount in a manner contrary to law. Both the "coerced loan" and the "presumptive contract" rates necessarily include profit and lost opportunity costs inapplicable to the present value discount. Absent misplaced

reliance on the *Murel* doctrine of indubitable equivalence, there simply exists no support in the Code or legislative history for the result reached by the majority below. The formula method conforms both with the language of the statute, and with the process by which "discounting" has been historically defined.

Petitioners request that this petition for certiorari be granted in order that this Court may establish national guidelines governing the discounting of deferred payments to present value in the bankruptcy context.

Respectfully Submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 00-4167

[Filed October 10, 2002]

IN RE: LEE M. TILL and AMY M. TILL,
Debtors-Appellants.

Appeal from the United States District Court
for the Southern District of Indiana, Indianapolis Division
No. 00 C 1102
Larry J. McKinney, Chief Judge

JUDGES:
Before Hon. KENNETH F. RIPPLE, Circuit Judge, Hon. DANIEL A. MANION, Circuit Judge, Hon. ILANA DIAMOND ROVNER, Circuit Judge.

ORDER

Upon consideration of the Debtor-Appellants' petition for rehearing *en banc,* filed on September 3, 2002, no judge in active service has requested a vote thereon and the judges on the original panel have voted to deny the petition. Accordingly,

IT IS ORDERED that the petition for rehearing *en banc* is hereby DENIED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 00-4167

[Argued April 10, 2002 - Decided August 21, 2002]

IN RE: LEE M. TILL and	)
AMY M. TILL,	)
Debtors-Appellants.	)
	)

Appeal from the United States District Court
for the Southern District of Indiana, Indianapolis Division
No. 00 C 1102
Larry J. McKinney, Chief Judge

JUDGES:
Before RIPPLE, MANION and ROVNER, Circuit Judges.
ROVNER, Circuit Judge, dissenting.

OPINION

RIPPLE, *Circuit Judge*. Lee and Amy Till filed for bankruptcy protection under Chapter 13. SCS Credit Corporation, a secured creditor, objected to confirmation of the Tills' Chapter 13 plan on the ground that the interest rate SCS would be paid under Chapter 13's "cramdown" provision, *see* 11 U.S.C. § 1325(a)(5)(A)(ii), was insufficient.

The bankruptcy court confirmed the plan over SCS' objection; it held that the proper interest rate was the prime rate plus a risk adjustment of 1.5%. SCS appealed. The district court reversed the bankruptcy court's decision; it concluded that the "coerced loan" theory applied, and, consequently, that the interest rate should be based on what SCS would receive for a loan of similar risk and duration. The district court stayed remand of its order pending the Tills' further appeal to this court. For the reasons set forth in the following opinion, we vacate the judgment of the district court and remand the case for further proceedings with instructions.

I

BACKGROUND

Lee and Amy Till jointly filed for bankruptcy protection under Chapter 13. SCS Credit Corporation was the only creditor to object to confirmation of the Tills' amended Chapter 13 plan. SCS is a secured creditor and holds a security interest in an automobile. The vehicle was valued at $ 4,500. SCS is a sub-prime lender, which means that it services borrowers with credit histories too poor to qualify for prime-rate auto loans. The Tills are such borrowers. The interest rate on the Tills' loan was 21%. The Tills' plan invoked the "cramdown" provision of Chapter 13.

Under Chapter 13's cramdown provision, a bankruptcy plan will be confirmed over the objection of a secured creditor if the creditor retains its lien on the collateral, and the creditor receives cash payments over the course of the plan that are equivalent to the value of the collateral on the plan's effective date. *See* 11 U.S.C. §

1325(a)(5)(B). To achieve this statutory requirement, the bankruptcy court must determine the value of the collateral, and the debtor must pay interest to account for the time value of money. Under the Tills' reorganization plan, the interest rate on SCS' secured claim would be 9.5%. SCS contended that this rate would not provide SCS with the present value of its collateral, as required by the cramdown provision. SCS submitted that the rate should be 21%, the interest rate it would have earned if SCS had foreclosed on the vehicle, sold it and then reinvested the proceeds in another sub-prime auto loan.

The bankruptcy court conducted a hearing to consider SCS' objection. The Tills presented the testimony of a finance professor who testified that an interest rate of 9.5%, which he based on the prime rate plus a risk premium of 1.5%, would be sufficient. He admitted, however, that he had no experience working for a creditor and only a limited understanding of the sub-prime auto lending market. SCS presented the testimony of its general manager, Neil Bird, and the sales manager of Instant Auto Finance, which had written the loan to the Tills and then had assigned it to SCS. Both witnesses testified that SCS had received 21% interest on all of its loans because borrowers like the Tills are poor credit risks. Bird also testified that SCS usually did not get paid the full amount under Chapter 13 plans because the debtors often cannot fulfill their obligations under the plan.

The bankruptcy court interpreted our decision in *Koopmans v. Farm Credit Services of Mid-America*, 102 F.3d 874 (7th Cir. 1996), to endorse a prime rate plus a risk premium method of calculating the proper cramdown interest rate. The court rejected the "coerced loan" theory of the

cramdown provision advocated by SCS. Following what it believed to be the holding of *Koopmans*, the bankruptcy court confirmed the Tills' plan with an interest rate of 9.5% applied to SCS' claim.

SCS then appealed to the United States District Court for the Southern District of Indiana. SCS reasserted its argument that it was entitled to 21%, the rate it would earn on a loan if it had foreclosed on the collateral and then had used the proceeds to issue a new loan. The district court agreed. The court held that the bankruptcy court had misread *Koopmans* and that *Koopmans* required that SCS receive the interest rate it would have earned on a new loan financed by the proceeds from the sale of its collateral. Based on the record in the bankruptcy court, the district court concluded that 21% was the proper rate and accordingly reversed the bankruptcy court's decision. The Tills now appeal that decision to this court.

II

DISCUSSION

A.

The issue before us--the appropriate approach to determine the applicable interest rate under Chapter 13's cramdown provision--first presents us with a question of statutory interpretation. We review this question de novo. The application of that method to the particular facts of this case is reviewed for clear error. *See In re Smithwick*, 121 F.3d 211, 215 (5th Cir. 1997).

The Tills submit that we should reverse the district court and reinstate the bankruptcy court's decision. In their view, a "market formula" method, such as the one adopted by the bankruptcy court in this case, appropriately implements the statutory mandate. SCS, however, contends that the "coerced loan" method, adopted by several Courts of Appeals and by the district court in this case, more accurately reflects the statutory intent.

When a petition is filed under Chapter 13 of the Bankruptcy Code, a bankruptcy court confirms the plan if several conditions are met. *See* 11 U.S.C. § § 1325(a)(1)-(6).[1] For secured creditors, this provision offers three possible

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[1] The statute provides:

Except as provided in subsection (b), the court shall confirm a plan if --

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

prerequisites to confirmation, one of which must be satisfied before a Chapter 13 plan can be confirmed. If the secured creditor consents, *see* 11 U.S.C. § 1325(a)(5)(A), or the debtor surrenders the collateral, *see id.* § 1325(a)(5)(C), or if the plan invokes 11 U.S.C. § 1325(a)(5)(B), known colloquially as Chapter 13's "cramdown" provision, a Chapter 13 plan will be confirmed, as long as the other conditions of confirmation are met. *See* Todd J. Zywicki, *Cramdown and the Code*, 19 T. Marshall L. Rev. 241, 242-43 (1994). The cramdown provision permits a bankruptcy court to confirm a debtor's Chapter 13 plan over a secured creditor's objection if "the plan provides that the holder of such claim retain the lien securing such claim; and the value,

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(5) with respect to each allowed secured claim provided for by the plan --

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; and

(6) the debtor will be able to make all payments under the plan and to comply with the plan.

11 U.S.C. § 1325(a).

as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim." 11 U.S.C. § 1325(a)(5)(B).[2] Both Chapter 11, *see* 11 U.S.C. § 1129(b)(2)(A)(i)(II), and Chapter 12, *see* 11 U.S.C. § 1225(a)(5)(B)(ii), contain analogous cramdown provisions. Courts have considered all three provisions to be similar and have analyzed them interchangeably.[3]

Before a plan invoking the cramdown provision can be confirmed, a bankruptcy court must make two determinations.

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[2] The allowed amount of a secured creditor's claim is the value of the collateral. The Code divides a secured creditor's claim into two portions, a secured portion and an unsecured portion. The secured portion is equal to the value of the collateral (for undersecured creditors) on the plan's effective date, the unsecured portion is the amount of the debt still owed to the creditor over and above the value of the collateral. *See United States v. Ron Pair Enters.*, 489 U.S. 235, 239, 103 L. Ed. 2d 290, 109 S. Ct. 1026 (1989). With respect to this excess amount, the secured creditor is treated like an unsecured creditor. *See id.*

[3] *See, e.g., Koopmans v. Farm Credit Servs. of Mid-America, ACA*, 102 F.3d 874, 875 (7th Cir. 1996) (citing cases interpreting Chapter 13's cramdown provision in a Chapter 12 case); *In re Smithwick*, 121 F.3d 211, 213 (5th Cir. 1997) (describing the cramdown provisions of Chapter 11 and Chapter 12 as analogous and citing to Chapter 11 cramdown cases in Chapter 12 case); *In re Fowler*, 903 F.2d 694, 697 (9th Cir. 1990) (finding that analysis in Chapter 11 cramdown cases also applied to Chapter 12 case); *United States v. Arnold*, 878 F.2d 925, 928 (6th Cir. 1989) (finding cramdown provisions of Chapter 12 and Chapter 13 to be identical).

First, it must determine the value of the collateral as of the effective date of the plan. *See Assocs. CommercialCorp. v. Rash*, 520 U.S. 953, 960-62 (1997). Once that value is determined, the bankruptcy court must then decide upon a stream of payments over the course of the plan that will provide the creditor with "value . . . not less than the allowed amount of such claim." 11 U.S.C. § 1325(a)(5)(B)(ii). To compensate a secured creditor for its delay in receiving the value of the collateral, the creditor must receive interest to account for the time value of money. *See* John K. Pearson, et al., *Ending the Judicial Snipe Hunt: The Search for the Cramdown Interest Rate*, 4 Am. Bankr. Inst. L. Rev. 35, 36-38 (1996). Thus, the second determination a bankruptcy court must make is the rate of interest to be charged. This issue has caused significant disagreement among the courts of appeals, bankruptcy courts and commentators. *See* Monica Hartman, Comment, *Selecting the Correct Cramdown Interest Rate in Chapter 11 and Chapter 13 Bankruptcies*, 47 U.C.L.A.L. Rev. 521, 532-44 (1999) (discussing the dominant approaches and the criticism each has received); David G. Epstein, *Don't Go and Do Something Rash About Cram Down Interest Rates*, 49 Ala. L. Rev. 435, 443-59 (1998) (discussing the divisions among courts of appeal); Matthew Y. Harris, Comment, *Chapter 13 Cram Down Interest Rates, 67 Miss. L.J. 567, 569-80 (1997)* (discussing the current approaches and their critics).

B.

Our ultimate task is to ascertain the policy decision made by Congress in enacting this statutory provision. This task requires that we understand the command of the statute. We therefore begin, as we always must, with the text of the

statute. We focus on the plain wording of the provision before us and on the statutory structure of which that provision is a part.[4] Examining both the text of the cramdown provision and the structure of the statute, we think it is clear that Congress intended that, under § 1325(a)(5)(B)(ii), the secured creditor, who is being forced to accept the debtor's plan and to forfeit his right to foreclose and sell the collateral, is to be compensated for the diminution of his present interest in the collateral. In short, from the debtor's perspective, it is necessary to pay for the continued use of the collateral at a rate that will preserve the value of the creditor's interest.

In ascertaining the precise obligation of the debtor under the cramdown provision, it is helpful to compare its requirements to the other provisions of § 1325(a)(5) that offer alternative ways of protecting the interest of a secured creditor in a Chapter 13 plan. We think it is reasonable to presume that Congress intended that each of these options afford the secured debtor somewhat equivalent protection.

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[4] In the case of an ambiguity in the statute, we sometimes find helpful, as long as it is read with prudence and caution, the legislative history of the provision. Although we have no need to resort to this device here, we note in passing that it is not very helpful to the task at hand. The House Report accompanying the 1978 Bankruptcy Act states that "value as of the effective date of the plan . . . indicates that the promised payment under the plan must be discounted to present value as of the effective date of the plan. The discounting should be based only on the unpaid balance of the amount due under the plan, until that amount, including interest, is paid in full." H.R. Rep. 95-595 at 408, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6364. The report does not address the appropriate method of calculating the interest rate.

Certainly, none of the three was designed to provide the debtor or the creditor with a windfall.

The three possibilities are straightforward: (1) a creditor consents to the plan; (2) the debtor turns over the collateral to the creditor; or (3) the debtor invokes the cramdown. A creditor will only consent if the plan adequately protects its interests. *See* Pearson, *supra*, at 49-50 (describing the efforts of creditors and debtors to come to an agreement to avoid bankruptcy litigation). If the creditor receives the collateral, then its rights under state law are vindicated and its contract with the debtor is fulfilled; in such a circumstance, the secured creditor's rights are not impaired by the Bankruptcy Code. The creditor may still seek the unsecured portion of its claim in bankruptcy, but it proceeds as an unsecured creditor and without the preference the Code gives to secured creditors. Given these two alternate modes of protection afforded by the statute, it is logical to conclude that the interest rate under the cramdown provision must put the creditor in a position reasonably equivalent to the position it would be in had it consented to the plan or had it received and then sold the collateral. There seems to be a consensus on this point among courts of appeal that have addressed this issue. All agree that the rate should compensate the creditor for its delay in receiving the value of the collateral. *See, e.g., Koopmans v. Farm Credit Servs. of Mid-America, ACA*, 102 F.3d 874, 874 (7th Cir. 1996); *In re Smithwick*, 121 F.3d 211, 214 (5th Cir. 1997); *In re Valenti*, 105 F.3d 55, 59-60 (2d Cir. 1997); *GMAC v. Jones*, 999 F.2d 63, 66-67 (3d Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d 1126, 1129-30 (4th Cir. 1993); *In re Fowler*, 903 F.2d 694, 696-97 (9th Cir. 1990); *In re Hardzog*, 901 F.2d 858, 859-60 (10th Cir. 1990); *United States v. Arnold*, 878 F.2d 925, 928-29 (6th

Cir. 1989). "If the debtor chooses to maintain possession of the secured collateral . . . then the debtor must compensate the creditor for the full value of the allowed secured claim." *In re Valenti*, 105 F.3d at 59.

C.

Despite the consensus on the objective of the statute, courts have developed divergent formulae for calculating the interest rate. Even here, however, there is consensus about a starting point. Courts agree that a "market" rate of interest should apply. *See Koopmans*, 102 F.3d at 874-75; *In re Smithwick*, 121 F.3d at 214; *In re Valenti*, 105 F.3d at 63; *GMAC*, 999 F.2d at 66-67; *United Carolina Bank*, 993 F.2d at 1129-30; *In re Fowler*, 903 F.2d 694, 697 (9th Cir. 1990); *In re Hardzog*, 901 F.2d at 859-60; *Arnold*, 878 F.2d at 927-28; *see also* Pearson, *supra* at 40-41; Epstein, *supra* at 443. There is disagreement, however, about what rate of interest will adequately ensure that the creditor receives full value of his secured claim.

1.

Under one approach, known as the "cost of funds method," the interest rate is set at the rate the creditor would have to pay to borrow the amount equal to the collateral's value. *See In re Valenti*, 105 F.3d at 64 (holding that, although cost of funds approach "more appropriately reflects the present value of a creditor's allowed claim," it is difficult to administer, and therefore the interest rate should be "fixed at the rate on a United States Treasury instrument with a maturity equivalent to the repayment schedule under the debtor's reorganization plan"); 8 Lawrence P. King et al.,

Collier on Bankruptcy, P 1325.06[3][B] (15th ed. 2001) (advocating cost of funds approach). No court of appeals has adopted the cost of funds method without further refinement. In *In re Valenti*, the Second Circuit expressed the view that this method was the best of the approaches employed by the various federal courts, but chose to adopt, for the sake of efficiency and ease of administration, a standard rate for all cramdown cases. *See In re Valenti*, 105 F.3d at 64. As we shall discuss in more detail later, under the Second Circuit approach, the Chapter 13 plan ought to set the interest rate at the rate for Treasury instruments with a maturity equivalent to the repayment schedule set forth in the plan of reorganization. This rate ought then to be adjusted to take into account the creditor's risk in not receiving the payments scheduled under the plan. *See id*. The cost of funds' approach is advocated by *Collier on Bankruptcy* and has been adopted by some bankruptcy and district courts.

The cost of funds method is not without its flaws. First, as the Ninth Circuit has observed, charging an interest rate equal to the creditor's borrowing rate forces the creditor to make a firm commitment to borrow (and repay) funds secured only by the risky stream of payments under the debtor's Chapter 13 plan and the creditor's continuing lien on a depreciating piece of collateral. *See In re Camino Real Landscape Maint. Contractors, Inc.*, 818 F.2d 1503, 1506 (9th Cir. 1987). Such a rate does not give the secured creditor value equivalent to his allowed claim. Second, "it is doubtful that the secured creditor has an unlimited supply of credit." Michael E.S. Frankel, *The Emerging Fixed Cramdown Rate Regime*, 2 U. Chi. L. Sch. Roundtable 643, 647 (1995). The cost of funds method presupposes that a creditor will opt to exhaust some of its own credit in order to replace the liquid

capital it would have received after foreclosure and sale. Many Chapter 13 creditors are not in a financial position to take on such a commitment and, consequently, the imposition of such terms on them would not afford them the full value of their secured interest and would deprive them of the protection of the cramdown provision. Third, the cost of funds approach is likely to provide a windfall to the debtor. As a practical matter, it allows the debtor to step into his creditor's shoes and pay interest for use of the collateral on the terms that he would enjoy if he were the secured creditor. This approach does not compensate the creditor for the risk that the Chapter 13 plan will fail and leave the creditor with only the remedy of foreclosure and sale of depreciated collateral.

A second approach, which is an adaption of the cost of funds method, is the formula method. The Second Circuit, *see In re Valenti*, 105 F.3d 55, 63 (2d Cir. 1997), has adopted the formula method; the Ninth Circuit, *see In re Fowler*, 903 F.2d 694, 698 (9th Cir. 1990), and Eighth Circuit, *see United States v. Doud*, 869 F.2d 1144, 1146 (8th Cir. 1989), have endorsed the formula method but have not adopted an exclusive, strict formula; instead those courts have vested significant discretion in the bankruptcy courts. "The formula approach requires the court to adopt a risk-free market rate as a base, and then add a risk premium corresponding to the court's determination of the riskiness of the reorganization plan." Pearson, *supra*, at 50. As we have noted earlier, the Second Circuit uses the "rate on a United States Treasury instrument with a maturity equivalent to the repayment schedule under the debtor's reorganization plan"

and a risk premium of one to three percent. *In re Valenti*, 105 F.3d at 64.

The formula method as adopted by our colleagues in the Second Circuit has the advantage of being clear and predictable. The base rate is readily ascertainable, and there is a small range of risk adjustment. We do not believe, however, that the formula approach necessarily will produce an interest rate that complies with the statutory requirement that the creditor receive "value . . . [which is] not less than the allowed amount of such claim" over the course of the plan. 11 U.S.C. § 1325(a)(5)(B)(ii). Congress sought to protect the secured creditor who is forced into the cramdown situation with protection against several factors: (1) the possibility that his continued credit to the now-bankrupt debtor would not be repaid; (2) the reality that the collateral will continue to depreciate either at the same rate as it has in the past or at a different rate, depending on the nature of the collateral and the prevailing market conditions; (3) the cost of continuing to service the loan in question. Congress left to the bankruptcy courts the task of ascertaining the appropriate rate which would protect against all of these factors. As this court noted in *Koopmans*, market participants may choose different methods of calculating the market rate of interest for the new situation precipitated by the debtor's invocation of the cramdown provision. *See Koopmans*, 102 F.3d at 875. There are a multitude of possible creditor/debtor relationships subject to the cramdown provision. Each presents its own risks; to adopt a standard interest rate with limited discretion vested in the bankruptcy court only to take into consideration the contingency of nonpayment would not necessarily fulfill the statutory command that the creditor be afforded the full value of his interest at the time the reorganization plan

becomes effective. The statutory provision necessarily leaves the particular questions of valuation to the informed discretion of the bankruptcy court. Our adoption of a rigid formula would unduly restrict that discretion. The statute contemplates a more particularized inquiry, and we are bound by Congress' policy choice in this regard.

3.

A third approach, and the one that we adopted in *Koopmans*, has been described as the "coerced loan" or the "forced loan" method. Courts taking this view conceptualize the cramdown provision as forcing creditors to extend a new line of credit to the debtor. Consequently, "the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." *Koopmans*, 102 F.3d at 875. This approach views § 1325(a)(5)(B)(ii) as "seeking to put the secured creditor in an economic position equivalent to the one it would have occupied had it received the allowed secured amount immediately, thus terminating the relationship between the creditor and the debtor." *GMAC*, 999 F.2d at 66-67; *see also In re Smithwick*, 121 F.3d at 214.

Koopmans was decided under the cramdown provision of Chapter 12, which applies to family farms. *See Koopmans*, 102 F.3d at 874. We wrote that in a cramdown, "the secured creditor is entitled to the 'indubitable equivalence' of its property interest, which means a stream of payments including interest that adds up to the present value of its claim." *Id.* at 874 (quoting *In re Murel Holding Corp.*, 75 F.2d 941, 942 (2d Cir. 1935) (L. Hand, J.)). The question there, as here, is: "At what rate of interest will [the secured

creditor] be as well off in the reorganization as if it had been allowed to foreclose on and sell the [collateral]." *Id*. We held that "the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." 102 F.3d at 875. We so held "without implying that 'prime-plus' is the only way to approximate the market rate of interest--for participants in the market may use other methods . . . ." *Id*.

Some courts, including the bankruptcy court in this case, have read our holding in *Koopmans* to endorse the formula method discussed above. It is true that we affirmed the decision of the bankruptcy court, which had:

> approximated *this* by starting with the prime rate of interest, which it found prevalent for new 20-year well-secured agricultural loans at the time, and adding 1.5 percent because it deemed this extension of credit more risky than the norm in light of the Koopmans' sorry repayment record. This produced a floating rate, 10.5 percent (9 percent +1.5 percent) at the time the bankruptcy court approved the plan.

Koopmans, 102 F.3d at 875 (emphasis added). However, "this" was the "market rate of interest, at the time of the hypothetical foreclosure, for loans of equivalent duration and risk." *Id*. at 874-75. In *Koopmans*, the forced loan approach produced a 10.5% interest rate based upon the prime rate plus a risk factor; this result was a realistic approximation of the interest rate that the creditor would have received on a new loan of the same duration and risk because the secured

creditor in *Koopmans* was oversecured, and the chosen rate was the one for well-secured agricultural loans. *See id*. at 874-75. *Koopmans* did not endorse a formula approach and should not be read to have endorsed such an approach. As we emphasized in *Koopmans*, "on *this* record, the market's approach is prime-plus." *Id*. at 875. It is clear that *Koopmans* did not adopt the prime-plus rate; it adopted the coerced loan method, the specific application of which led to the prime-plus rate. *See id*.

Only the Second Circuit has explicitly rejected the forced loan method. *See In re Valenti*, 105 F.3d at 64. The court in *Valenti* thought the coerced loan method inappropriate because it computes "'present value' to include the profit that the creditor would have generated had the creditor received the value of the collateral immediately." *Id*. at 63. The court elaborated: "The objective of § 1325(a)(5)(B)(ii) is to put the creditor in the same economic position that it would have been in had it received the value of its allowed claim immediately. The purpose is *not* to put the creditor in the same position that it would have been in had it arranged a 'new' loan." *Id*. at 64. The court also opined that "the value of the creditor's allowed claim does not include any degree of profit." *Id*. Like several other circuits, we respectfully decline to adopt this analysis. Like the Third Circuit, *see GMAC*, 999 F.2d at 69, and the Fifth Circuit, *see Smithwick*, 121 F.3d at 214, we believe that to exclude the element of profit from the fixing of the market rate would violate the statutory directive that the creditor be placed in the same position as the one in which it would have been if it had been allowed to end the lending relationship by repossessing the collateral.

By determining the rate that the creditor in question would obtain in making a new loan in the same industry to a debtor who is similarly situated, although not in bankruptcy, *see GMAC*, 999 F.2d at 67 n. 4, we acknowledge that we are approximating, not necessarily duplicating precisely, the present value of the collateral to the creditor as that statute requires. The continuation of the old contract rate to the bankrupt debtor under the supervision of the bankruptcy court will involve some risks that would not be incurred in a new loan to a debtor not in default and also result in some economies.[5] Nevertheless, like our colleagues in the Third Circuit, *see GMAC*, 999 F.2d at 68-69, and Fifth Circuit, *see Smithwick*, 121 F.3d at 214, we believe that the old contract rate will yield a rate sufficiently reflective of the value of the collateral at the time of the effectiveness of the plan to serve as a presumptive rate. Therefore,

> [i]n the absence of a stipulation regarding the creditor's current rate for a loan of similar

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[5] As the Third Circuit noted in *GMAC*, an extension of the old loan will not involve the usual initiation costs and the bankruptcy trustee will assume some, although not all of the monitoring functions that must be undertaken in the administration of the loan. Other "relational costs" will also be less. *See GMAC*, 999 F.2d at 68. On the other hand, the usual "equity cushion" accompanying loans of this sort may be absent in the case of a coerced extension. *See id.* "An equity cushion exists when the appraised value of the collateral is greater than the value of the loan." *Id.* In a free market, uncoerced by the cramdown provision, a lender might well insist on a sizable equity cushion that is missing here. In a free market, the lender of an extension also might insist on a higher rate.

> character, amount and duration, we believe it would be appropriate for bankruptcy courts to accept a plan utilizing the contract rate if the creditor fails to come forward with persuasive evidence that its current rate is in excess of the contract rate. Conversely, utilizing the same rebuttable presumption approach, if a debtor proposes a plan with a rate less than the contract rate, it would be appropriate for a bankruptcy court to require the debtor to come forward with some evidence that the creditor's current rate is less than the contract rate.

GMAC, 999 F.2d at 70-71. The approach we endorse today will, in most cases, provide the best approximation of the proper rate. Thus, the bankruptcy courts are vested with significant discretion in the application of the method described in this opinion.

The district court properly determined that our earlier decision in *Koopmans* determined that the correct approach in ascertaining the appropriate interest rate in a cramdown situation is the coerced loan approach. Nevertheless, because our decision today sufficiently elaborates on that methodology and gives further guidance to the bankruptcy courts on this matter, we believe that the best course is to remand the case to the district court with instructions that the judgment of the bankruptcy court be vacated and that further proceedings consistent with this opinion be held in the bankruptcy court. We believe that fairness requires that both parties be afforded an opportunity to address the factors that we have identified in this opinion and that the bankruptcy court be given the

opportunity to employ the methodology that we have set forth today.

Conclusion

Accordingly, the judgment of the district court is vacated and the case is remanded with instructions. The parties shall bear their own costs of this appeal.

VACATED and REMANDED

DISSENT

ROVNER, *Circuit Judge*, dissenting. My colleagues hold that section 1325(a)(5)(B)(ii) entitles a creditor to the same interest rate that it would charge on a new loan to someone who is situated similarly (except for the bankruptcy) to the debtor. By its own account, the interest rate that SCS charges its customers for sub-prime, used car loans is whatever the market will bear. *In re Till*, No. 99-13425-13, Transcript of Continued Hearings on Trustee's Motion to Dismiss, etc., at 34, 38 (Bankr. S.D. Ind. Feb. 29, 2000). In the Tills' case, that was an eye-popping 21 percent. Compelling a debtor to pay such a burdensome rate of interest diminishes the feasibility of the Chapter 13 plan, *see* § 1325(a)(6); C. Frank Carbiener, *Present Value in Bankruptcy: The Search for an Appropriate Cramdown Discount Rate*, 32 S.D.L. REV. 42, 43 (1987), reduces the likelihood that unsecured creditors will receive any remuneration, *see In re Scott*, 248 B.R. 786, 793 (Bankr. N.D. Ill. 2000), and is inconsistent with the fresh start that Chapter 13 was intended to provide to debtors, *see Local Loan Co. v. Hunt*, 292 U.S. 234, 244, 54 S. Ct. 695, 699, 78 L. Ed. 1230 (1934); H.

Rep. No. 95-595, at 117 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6078. First and foremost, however, I believe it is contrary to the language and purpose of the statute.

Chapter 13's "cram down" provision obligates the debtor over the life of the plan to pay his creditor an amount of money "not less than the allowed amount" of the claim. 11 U.S.C. § 1325(a)(5)(B)(ii). Of course, a claim can only be allowed to the extent that it is secured, *see* 11 U.S.C. § 506(a), and so, when the creditor is under-secured as SCS was, the "allowed amount" of the claim corresponds to the value of the collateral underlying the loan (here, the automobile), *id. See ante* at 6 n.2; *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 961, 117 S. Ct. 1879, 1884-85, 138 L. Ed. 2d 148 (1997). This means that the debtor must commit to a stream of payments that ultimately will compensate the creditor for the present value of the collateral that the debtor has chosen to keep. *Ante* at 7. Furthermore, because the debtor will be paying the creditor for the collateral over the three-to five-year life of the plan, the statute obligates the debtor to pay interest to compensate the creditor for the delay. *E.g., G.M.A.C. v. Jones*, 999 F.2d 63, 66 (3d Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d 1126, 1129-30 (4th Cir. 1993); *In re Bellamy*, 962 F.2d 176, 185-86 (2d Cir. 1992), *abrogated on other grounds by Nobelman v. American Sav. Bank*, 508 U.S. 324, 113 S. Ct. 2106, 124 L. Ed. 2d 228 (1993). In this way, the statute recognizes the time value of money and attempts to place the creditor in the same position it would have been in had the debtor surrendered the collateral, enabling the creditor to liquidate it and reinvest the proceeds. *See Rash*, 520 U.S. at 962, 117 S. Ct. at 1885; *Hall*, 993 F.2d at 1130; *Jones*, 999

F.2d at 66. As for the rate of interest, courts are virtually unanimous in the view that the interest rate imposed under section 1325(a)(5)(B)(ii) should be a "market" rate. *Ante* at 10; Monica Hartman, Comment, *Selecting the Correct Cramdown Interest Rate in Chapter 11 and Chapter 13 Bankruptcies*, 47 UCLA L. REV. 521, 528 (1999); Matthew Y. Harris, Comment, *Chapter 13 Cram Down Interest Rates: Another Day, Another Dollar--A Cry for Help in Ending the Quest for the Appropriate Rate*, 67 MISS. L.J. 567, 569 (1997); Todd J. Zywicki, *Cramdown and the Code: Calculating Cramdown Interest Rates Under the Bankruptcy Code*, 19 T. MARSHALL L. REV. 241, 245 (1994). They are divided, however as to which among several market rates most fairly compensates the creditor for the delay in receiving the value of its collateral--the rate at which the creditor could borrow money to replace the collateral that the debtor has chosen to keep (the "cost of funds" approach), the prime rate or a U.S. Treasury rate adjusted upward for the risk of nonpayment (the "formula" approach), or the rate at which the creditor would make the same type of loan to someone like the debtor (the "coerced loan" approach).

The coerced loan approach that my colleagues embrace posits that the debtor's decision to keep the collateral in effect compels the creditor to extend a new loan to the debtor for the value of the collateral. *Ante* at 14; *see Jones*, 999 F.2d at 67, quoting *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427, 429 (6th Cir. 1982); *In re Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990). It further presumes that had the debtor instead surrendered the collateral, the creditor would have converted the collateral into cash and invested the money in the same type of loan that the debtor originally obtained--here, a sub-prime used car loan carrying a high rate

of interest. *See ante* at 14, citing *Koopmans v. Farm Credit Servs. of Mid-America, ACA*, 102 F.3d 874, 875 (7th Cir. 1996). Based on the notion that the debtor's retention of the collateral has deprived the creditor of this investment opportunity, the coerced loan camp reasons that the debtor must pay the same rate of interest the creditor could have earned had it loaned the amount of the collateral to someone else. *Ante* at 14.

The sole deprivation that can be charged to the debtor, however, is the retention of the collateral, not the investment that the creditor presumably would have made with the proceeds of that collateral. *See In re Valenti*, 105 F.3d 55, 63-64 (2nd Cir. 1997), *abrogated on other grounds by Rash*, 520 U.S. 953, 117 S. Ct. 1879, 138 L. Ed. 2d 148. Had the Tills elected to surrender the collateral, all that SCS would have received is a 1991 Chevrolet S-10 truck, not a new loan package. It would have been SCS' responsibility to sell the truck and then make a new loan with the proceeds of the sale; and, of course, there would have been costs associated with both of those transactions. *See Hall*, 993 F.2d at 1131; *see also Koopmans*, 102 F.3d at 874 (deeming the appropriate question to be "at what rate of interest will [the secured creditor] be as well off in the reorganization as if it had been allowed to foreclose on and sell the [collateral]"). Requiring the debtor to pay the creditor the same rate of interest that the creditor would charge on a new loan to another consumer thus over-compensates the creditor, because it fails to account for the costs that the creditor would incur in funding the new loan. *See* 8 COLLIER ON BANKRUPTCY, P 1325.06, p. 1325-35-36 (Lawrence P. King, et al., eds., 15th rev. ed. 2002); *In re Ivey*, 147 B.R. 109, 116 (M.D.N.C. 1992), *overruled by Hall*, 993 F.2d 1126.

In this respect, the costs of funds approach comes closer to recognizing the economic consequences of the debtor's decision to keep the collateral. *See Valenti*, 105 F.3d at 64. Strictly speaking, the debtor's retention of the collateral does not preclude the creditor from making a new loan, it simply deprives the creditor of an asset that the creditor could convert into money and use to fund the new loan. A straightforward way to account for that deprivation is to ask what it would cost the creditor to obtain the cash equivalent of the collateral from an alternative source. 8 COLLIER, P 1325.0606, p. 1325-35; *In re Benson*, 9 B.R. 854, 858 (Bankr. N.D. Ill. 1981); *see also* Carbiener, 32 S.D.L. REV. at 63 (noting that this is consistent with law's general approach to mitigation of damages). Assume, for example, that SCS could borrow the cash equivalent of the Tills' truck at an interest rate of 10 percent and then lend that money to another consumer at a rate of 21 percent. Under that scenario, the cost of the Tills' decision to keep the truck would not be the full 21 percent that SCS would earn on its investment in another consumer loan, but the 10 percent that SCS would have to pay to borrow the money it otherwise would have obtained by liquidating the truck. Critics of the cost of funds approach point out that a creditor is unlikely to have an unlimited supply of credit and that it may be impractical and unjust to expect the creditor to borrow the funds necessary to replace the collateral that the debtor has chosen to keep. *See ante* at 11-12; *Hall*, 993 F.2d at 1130. Whether the creditor can, will, or should borrow to replace the funds it otherwise would realize from the collateral is entirely beside the point, however. The task at hand is to decide what rate of interest will reasonably compensate the creditor for the delay in receiving the value of the collateral from the debtor. *See* Zywicki, 19 T. MARSHALL L. REV. at 257. The cost of

funds approach better approximates this rate by examining what it would cost the creditor to replace the collateral with money from another source.

The principal disadvantage of the cost of funds method is that it calls for an individualized inquiry that will burden the parties and the court and may lead to disparate results depending on an individual creditor's cost of borrowing. *Valenti*, 105 F.3d at 64; *Hardzog*, 901 F.2d at 860. Given the relatively small amounts of money that are involved in a Chapter 13 proceeding, any approach that invites litigation and adds to the cost of the proceeding is undesirable. *See* Carbiener, 32 S.D.L. REV. at 59-60. The rate that ought to prevail under section 1325(a)(5)(B)(ii) is one that is predictable to the parties, and thus readily susceptible to agreement between them without court intervention. *See* § 1325(a)(5)(A).

In those respects, a formulaic approach that employs as a base rate of interest an easily referenced rate like the prime rate or the rate on U.S. Treasury instruments, and which allows for modest enhancements to the base to account for the risk of nonpayment, is superior, and I would commend it to the court. *See Valenti*, 105 F.3d at 64; *United States v. Doud*, 869 F.2d 1144, 1145 (8th Cir. 1989); Carbiener, 32 S.D.L. REV. at 63-65. The Treasury rate and the prime rate are both easily ascertainable rates that spare the court and the parties of the need for a potentially time-consuming and expensive inquiry into prevailing market rates of interest available to either the debtor or creditor. Each reflects two of the three components of a market interest rate--expected inflation, and "real" interest. *See* Hartman, 47 UCLA L. REV. at 531. The prime rate also includes the third

component--the risk of nonpayment (*see id.*)--and in that sense may represent a better starting point than the Treasury rate. *See Koopmans, 102 F.3d at 875;* Hartman, 47 UCLA L. REV. at 545. At the same time, because the prime rate is available to only the most credit-worthy borrowers, its risk component is arguably too small to compensate the creditor for the risk of nonpayment by a Chapter 13 debtor. *See Koopmans*, 102 F.3d at 875. Either rate, in any event, can be adjusted upward to account for the greater risk of nonpayment by a debtor in bankruptcy. *Id.* Courts employing the formula approach recognize that enhancements of one hundred to three hundred basis points would normally suffice for this purpose. *E.g., Valenti*, 105 F.3d at 64. What level of enhancement is called for in the individual case is a question wisely left to the bankruptcy court, which is better situated to assess the risk of nonpayment and may adjust the rate accordingly without extensive evidentiary hearings. *See* Hartman, 47 UCLA L. REV. at 545-46; Harris, 67 MISS. L.J. at 582.[1]

The lower interest rate produced by the formula approach (or for that matter by the cost of funds approach)--seemingly piddling by comparison with the rate produced by

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[1] This is essentially the approach that the bankruptcy court followed here, albeit after hearing testimony as to the prime rate and the prevailing rates of interest in the market for automobile loans. *See In re Till*, No. 99-13425-FJO-13, Order Confirming Amended Plan (Bankr. S.D. Ind. June 27,2000). A formula approach that starts with an easily referenced prime or Treasury rate and calls for an enhancement commensurate with the risks posed by the debtor's reorganization plan would largely obviate the need for such testimony. *See* Hartman, 47 UCLA L. REV. at 546-47.

the coerced loan approach in a sub-prime loan case like this one--may at first blush appear inadequate to compensate the creditor for the costs that the involuntarily extended lending relationship imposes, including in particular the risk that the debtor will be unable to discharge his obligations under the reorganization plan. *See ante* at 13; *see also Jones*, 999 F.2d at 67, 68-69; *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503, 1506 (9th Cir. 1987). But courts should consider the extent to which the creditor has already been compensated for this risk in the rate of interest that it charged to the debtor in return for the original loan. Sub-prime lenders charge exorbitant rates of interest precisely because there is a high risk that their borrowers will default on their loan obligations. *See* Kathleen C. Engel and Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1265-66 (2002); Mavis W. Kennedy, *Don't Let Your Client Be Labeled a Predatory Lender*, 89 ILL. B.J. 595, 597 (2001). These lenders understand that a significant number of their borrowers will not make good on their obligations--may, in fact, end up in bankruptcy. Yet, they continue to make high-risk loans because the money they receive from nondefaulting borrowers is enough to offset that risk; they would not remain in business otherwise. In short, the high interest rate on the Tills' used car loan already accounted for the very possibility of bankruptcy (and with it, the Tills' ability to keep their truck rather than surrender it) that has come to pass. Awarding SCS a second risk premium pursuant to section 1325(a)(5)(B)(ii) may well be unnecessary and inappropriate.

Courts must also have in mind the ways in which bankruptcy law and procedure also work to compensate the creditor for the risk of nonpayment. Insofar as the typical

automobile loan is concerned, the manner in which the loan collateral is valued for purposes of the bankruptcy itself provides the creditor with substantial compensation. Because the automobile typically is the only collateral securing the loan, and because automobiles depreciate relatively quickly, the creditor typically finds itself under-secured. That brings into play section 506(a) of the Code, which, as I noted at the outset, limits the amount of the creditor's allowed secured claim to the value of the automobile itself. In *Rash*, however, the Supreme Court held that for purposes of section 506(a), that value is to be determined by asking not how much the *creditor* could be expected to realize upon foreclosure and liquidation of the collateral, but by how much the *debtor* would have to pay in order to replace the collateral. 520 U.S. at 965, 117 S. Ct. at 1886. As Chief Judge Wedoff has pointed out, the replacement value of an automobile to the debtor will normally be significantly higher than the wholesale value that the creditor typically could expect to realize if it repossessed and liquidated the vehicle. *Scott*, 248 B.R. at 792. So by requiring the debtor who keeps the collateral to pay his creditor an amount equal to the replacement cost of the vehicle, the Supreme Court has already ensured that the creditor will be afforded significant compensation for the risk of non-payment. *Id.; see also* David G. Epstein, *Don't Go and Do Something Rash About Cram Down Interest Rates*, 49 ALA. L. REV. 435, 455 n. 79 (1998). Consequently, "applying a rate of interest that fully reflects risk of nonpayment--like the contract rate in the present case--to a secured claim amount that already includes substantial 'risk protection' results in a windfall for the secured creditor, to the detriment of unsecured creditors." *Scott*, 248 B.R. at 792, 793. Other provisions of the Code also operate, albeit more modestly, to reduce the risk of non-

payment along with the costs occasioned by the debtor's election to retain the collateral: (1) Before confirming the Chapter 13 plan, the Bankruptcy Court must be convinced that it is feasible in the sense that the debtor has the resources to meet his obligations, § 1325(a)(6); (2) wage orders can be used to ensure that the debtor does not inadvertently miss payments; (3) unsecured debt can be reduced or restructured; and (4) collection costs to the creditor are eliminated, while administrative costs are borne primarily by the Chapter 13 trustee. *See In re Carson*, 227 B.R. 719, 724 (Bankr. S.D. Ind. 1998); *see also Jones*, 999 F.2d at 69 & n. 8; Carbiener, 32 S.D.L. Rev. at 60-62.

I believe that my colleagues are correct to read this court's opinion in *Koopmans* as a nod in the direction of the coerced loan theory that they have elected to adopt; still, *Koopmans* ought not to be viewed as dispositive of the question we decide today. *See* Epstein, 49 ALA. L. REV. at 454 ("[*Koopmans*] can better be described as a case . . . that does not require bankruptcy courts to use any particular approach to determine the market rate."); *Carson*, 227 B.R. at 721 n.5 (noting that *Koopmans* "does not fit neatly into any of the three categories"). Although the language of the *Koopmans* opinion endorses the coerced loan approach, 102 F.3d at 875, the decision actually affirms the bankruptcy court's decision to use the prime rate with an appropriate risk enhancement, *id*. Indeed, courts and commentators have had some difficulty deciding where in the ongoing debate over the appropriate interest rate *Koopmans* came down, as evidenced by the fact that we have been credited with endorsing all three of the major approaches. *See, e.g., In re Smithwick*, 121 F.3d 211, 214 (5th Cir. 1997) (construing *Koopmans* as adopting the coerced loan approach), *cert. denied*, 523 U.S. 1074, 118

S. Ct. 1516, 140 L. Ed. 2d 669 (1998); Epstein, 49 ALA. L. REV. at 454 (noting that *Koopmans* actually approved the bankruptcy court's use of the formula approach); Harris, 67 Miss. L.J. at 580 & n. 74 (construing *Koopmans* as approving cost of funds approach); Timothy D. Moratzka, *Chapter 13 Interest Rate Pegged to Treasury Rate in Second Circuit*, 1997 ABI JNL. LEXIS 259, 14 AM. BANKR. INST. J. 16, 16 (1997) (same). In truth, the consequences of the choice were modest in *Koopmans*, because the nature of the debt at issue in that Chapter 12 case (an over-secured farm mortgage) rendered the gap between the prime rate and the prevailing market rate for comparable agricultural loans small--indeed, once the bankruptcy court had enhanced the prime rate for additional risk, the two rates were roughly equivalent. *See* 102 F.3d at 875; *Koopmans v. Farm Credit Servs.*, 196 B.R. 425, 428 (N.D. Ind. 1996). By contrast, the disparity here (as in many other Chapter 13 cases involving sub-prime consumer loans) is dramatic, so that use of a market rate for a comparable consumer loan will have adverse consequences that we did not address in *Koopmans*.

The search for a "market" rate that will place the creditor in the same position that it would have been in had it been able to foreclose on the loan is in a sense futile, because given a choice, a creditor would almost always prefer to take possession of the collateral immediately rather than accept a stream of payments over time for the value of that collateral. *See Rash*, 520 U.S. at 962-63, 117 S. Ct. at 1885; *see also Ivey*, 147 B.R. at 117-18. That choice has been taken away from the creditor, however, by operation of a statute that aims to help the debtor by allowing him to keep an asset--like an automobile--which may be vital to his ability to generate income and attend to his family's day-to-day needs. Because

this situation is a creature of legislation rather than the market, the policy considerations reflected in the statute cannot be ignored. A creditor is entitled to interest sufficient to compensate it for the delay in receiving the value of the collateral securing the loan, and the rate at which interest is ordered must reflect the risk of non-payment. To some extent, as I have noted, SCS has already been compensated for that risk through the high rate of interest it originally charged the Tills and other borrowers like them; that rate took into account the very possibility of default that came to pass. To the extent that the Tills' retention of the truck imposes new risks on SCS, the valuation of collateral at its replacement cost provides a substantial cushion to account for those risks. Overcompensating the creditor by demanding that the debtor pay interest as high as the market for high-risk loans will bear greatly increases the burden on the debtor, and far from the fresh start that Chapter 13 was intended to give him, puts him back in the very situation that brought him into bankruptcy. That burden works to the detriment not only of the debtor, but to that of his other creditors, secured and unsecured.

I respectfully dissent.

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

[Filed November 1, 2000]

RE:
SCS CREDIT CORPORATION,
APPELLANT

LEE M. TILL and AMY M. TILL,
APPELLEES

IP 00-1102-C-M/S
DISTRICT COURT CASE NO.

Presiding Judge Larry J. McKinney Magistrate Judge V. Sue Shields

IN RE
LEE M. TILL and AMY M. TILL,
DEBTORS

99-13425-FJO-13
BANKRUPTCY CASE NO.

ORDER

Appellant creditor, SCS Credit Corporation (hereinafter "SCS"), has appealed the confirmation of the Chapter 13 Plan of Appellees Lee and Amy Till. The only issue concerns the proper interest rate the Tills must pay SCS on SCS's secured claim. The Plan set the interest at prime plus 1.5% and SCS asserts that under Seventh Circuit precedent the interest should have been set at the market rate. At the hearing on the objection to the Plan, SCS asserted that the market rate is 21%.

In reviewing a decision of the Bankruptcy Court, this District Court acts time of the confirmation of the plan. The record from the hearing in the Bankruptcy Court contains the testimony of three individuals addressing the appropriate interest rate. The Lees called an economics professor and SCS called a representative of Instant-Auto Finance and the general manager of SCS.

Professor Russell discussed the prime rate, defining it generally as the Rate banks charge their most credit worthy corporate customers and pointed out that the prime rate is a uniform rate across the country. He discussed factors that help determine that rate. He shared with the court his views on the factors that determine interest rates in the market. He looked at the average new car loan interest rate. He concluded, after being directed to consider the present value of these loans, and taking into account all the factors he had discussed that a fair interest rate for the automobile loans in this case would be nine and one-half percent. It is important to note that he did not testify about the market rate of loans similar to the loans in question, nor did he claim any expertise in the market in non-prime rates on auto loans, nor did he deny that such a market existed.

Craig Cook testified to 13 years' experience in a market for automobile loans he referred to as the sub-prime or non-prime market. He testified that in any loan situation in which the borrower had the same or similar credit history as the debtors in this case, the Tills, the interest rate was 21%. He indicated that as far as he knew that interest rate was determined by a consideration of what the market will bear. Neal Bird, an employee of SCS, testified that he had worked in the non-prime lender loan market for 4 years after working in the prime lender market for 9 years. His experience was that borrowers agreed to the 21% rate charged by non-prime lenders. He also opined that the 21% interest rate was determined more by what the market will bear than by a formula that takes into amount risk, profit, marketing costs and collection cost. He denied having a degree in economics or being an actuary.

Bankruptcy Judge Otte cited the *Koopmans* case. He also cited cases decided by Bankruptcy Judges Bayt and Metz, both of which applied a prime plus interest rate in similar cram down auto loan cases. Judge Otte adopted the reasoning of those cases. No separate findings of fact were entered.

The unrebutted testimony in this case is that there is a market for used car loans called the non-prime or sub-prime market. The unrebutted testimony is that the interest rate in this market is set not by economic considerations such as risk, transactional costs, and overhead. The unrebutted testimony is that the interest rate is set on no other consideration than what the market will bear. Potential borrowers are in this non-prime market because their credit histories are poor and they are therefore risky debtors. Presumably these borrowers cannot find a lender in the prime market. Presumably no

reasonable borrower would pay 21% interest on a vehicle if other cheaper rates were an as appellate tribunal and is governed by traditional standards of appellate review. Specifically, the Court "is constrained to accept the Bankruptcy Court's findings of facts unless they are clearly erroneous." *In Re Excalibur Auto Corp.*, 859 F.2d 454, 457, n. 3 (7th Cir. 1988); *In Re Longardner & Associates, Inc.*, 855 F.2d 455, 459 (7th Cir. 1988). "A finding is clearly erroneous if upon review of the entire record the reviewing court is left with the definite and firm conviction that a mistake has been committed." *Graham v. Lennington*, 74 B.R. 693, 695 ((S.D. Ind. 1987). "Generally, as long as the bankruptcy judge's inferences are reasonable and supported by the evidence, they will not be disturbed." *Id.*

Conclusions of law made by the Bankruptcy Court, however, must be reviewed *de novo. Excalibur Auto Corp.*, 859 F.2d at 457, n. 3; *Longardner & Associates, Inc.*, 855 F.2d at 459; *In Re Bonnett*, No. 87-2102 slip op. at 3 (7th Cir. Dec. 20, 1989). And, where the challenged finding is a mixture of law and fact, the clearly erroneous standard is also inapplicable. *Graham*, 74 B.R. at 965. The determination of the correct interest rate to be applied in this case for the SCS loan is a factual determination.

In the Seventh Circuit after the case of *Koopmans v. Farm Credit Services of Mid-America, ACA*, 102 F.3d 874, 875 (7th Cir. 1996) the interest rate to be applied under the cramdown provisions of 11U.S.C. §1225(a)(5)(B)(ii) is the market rate for loans of equivalent duration and risk which was available at the available to them. The choice these borrowers have may seem unfair: pay 21% or have no transportation.

Koopmans requires the Bankruptcy Court in a cramdown circumstance to set the rate of interest at the level that the creditor "could have obtained had it obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." at p. 875. Further, *Koopmans* warns, "The market rate must be used consistently." at. P.875. The controlling inquiries under *Koopmans* are whether there is a market for these loans and if there is what is the market rate. The answers to these inquiries, says *Koopmans*, will allow the court to factually determine what "rate of interest a creditor could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." The controlling inquiry is not into the changed nature of the risk of a loan once it becomes a part of a Chapter 13 plan.

The unrebutted evidence deduced at the hearing on the creditor's objection to the plan establishes that a sub-prime market exists and that its rate is 21%. Thus the unrebutted evidence here is that had SCS foreclosed on the Tills, SCS would have obtained the 21% rate in a loan of equivalent duration and risk. Whether this 21% interest rate may be set arbitrarily or that it may seem to take advantage of debtors who find themselves with bad credit histories is not the controlling inquiry. The fact that the contract rate is 21% is not controlling for this Court's decision. Again, what is controlling is the market rate.

For the above reasons, the judgment of the Bankruptcy Court is REVERSED and the matter is remanded for further consideration of the debtors' plan consistent with this opinion.

IT IS SO ORDERED this 1st day of November, 2000.

/s/ _____
Larry J. McKinney, Judge
United States District Court
Southern District of Indiana

Distributed to:

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APPENDIX D

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVI S ION

CASE NO.99-13425-FJO-13

[Filed June 27, 2000]

IN RE:	)
	)
LEE MADISON TILL	)
AMY HELEN TILL	)
Debtors	)
	)

ORDER CONFIRMING AMENDED PLAN

This matter came before the Court upon the filing of the Objection to Confirmation filed by SCS Credit Corp. The Court held a hearing on this matter on February 29, 2000. Subsequent to the hearing, the Debtors, SCS Credit Corp. and the Chapter 13 Trustee filed briefs or comments with the Court. This matter is now ready for the Court's consideration.

The Court, after reviewing this matter and having researched the relevant authorities, now makes the following entry.

Bankruptcy Court Order Confirming Amended Plan - 6/27/00

Summary of Facts

The indebtedness between the Debtors and SCS Credit Corp. ("SCS") is secured by a lien on a vehicle. The Debtors' Amended Plan provides for a 9.5% rate of interest to be paid to SCS on its indebtedness.

The creditor asserts that it is entitled to a 21% interest rate, which the creditor claims is the rate it would obtain if it foreclosed on the vehicle and reinvested the proceeds in loans of equivalent duration and risk as the loan made by the Debtors and the creditor. SCS asserts that the Debtors' amended plan fails to comply with the "present value" requirement.

The Debtors argue that this Court should not adopt the "coerced loan" approach as proposed by SCS. The Debtors encourage this Court to follow the line of cases which have found that the "objective of section 1325(a)(5)(B)(ii) is to put the creditor in the same economic position that it would have been in had it received the value of its allowed claim immediately", not to "put the creditor in the same position that it would have been in had it arranged a "new" loan." citing *In Re Valenti*, 105 F.3d 55, 64 (2nd Cir. 1997).

The Chapter 13 Trustee filed Comments with the Court asking the Court to uphold the 9.5% provided for by the Debtors in their Amended Plan for the following reasons: (i) it is easily ascertainable on a daily basis; (2) prime is a more general statement as to the condition of the financial market; (3) its use avoids increases/decreases in the interest rate that reflects the strengths or weaknesses of a particular

lender; (4) it resolves the problems inherent with the contract rate cases; (5) it is linked most directly to the real loss experienced by the creditor; and (6) it does not engage courts, debtors and creditors in the frustrating search for non-existent markets and non-existent "similar loans".

Legal Discussion

The Seventh Circuit dealt with this issue in *Koopmans v. Farm Credit Serv. of Mid-America, ACA*, 102 F.3d 874 (7th Cir. 1996). The Seventh Circuit affirmed the lower court's application of prime plus 1.5%. Judge Robert Bayt issued an opinion on October 1, 1998 dealing with the appropriate rate of interest to be included in the plan as to a secured lender on a vehicle. (*In re Carson*, 227 B.R. 719 (S.D. Ind. 1998). Judge Bayt, following *Koopman*, held that the appropriate rate of interest to meet the requirements of Section 1325(a) (5) (B) (ii) was prime plus 1.5%.

Judge Anthony Metz, in an unpublished opinion in *In re Pippins* (98-13561-AJM-13 dated February 17, 1999), addressed facts very similar to the ones before this Court. In *Pippins*, the same creditor, SCS Credit Corporation, filed an objection to the Plan that was the same objection that was filed in this case, wherein it asserts that the secured creditor is entitled to an interest rate of 21%. Judge Metz applied a 10% rate of interest which follows the same standard applied by Judge Bayt in *Carson* and by the Seventh Circuit in *Koopmans*.

This Court is not persuaded with the reasoning set forth in the unpublished memorandum decision (In the Matter

of Stahl-Karfomenos 93-33622) by Judge Dees on May 20, 1999 cited by SCS wherein he held that a non-prime creditor was entitled to receive 20.99% interest under a chapter 13 plan.

This Court adopts the "prime-plus" approach and holds that the appropriate rate of interest to be applied to SCS Credit Corporation's debt is 9.5%. Based upon the foregoing, this Court APPROVES. the confirmation of the Debtors' Amended Plan as filed and OVERRULES the Objection of SCS to the Amended Plan.

Date JUN 27 2000

/s/ _____
FRANK J. OTTE
BANKRUPTCY JUDGE

DISTRIBUTION:
Attorneys of Record
United States Trustee

APPENDIX E

RELEVANT STATUTES

SECTION 361 (11 U.S.C. § 361)

§ 361. Adequate protection.

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—

* * * *

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

* * * *

SECTION 362 (11 U.S.C. § 362)

§ 362. Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

* * * *

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay–

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization; or

* * * *

SECTION 502 (11 U.S.C. 502)

§ 502. Allowance of claims or interests.

* * * *

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

* * * *

(2) such claim is for unmatured interest;

* * * *

SECTION 506 (11 U.S.C. § 506)

§ 506. Determination of secured status

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

* * * *

SECTION 726 (11 U.S.C. § 726)

§ 726. Distribution of property of the estate

(a) Except as provided in section 510 of this title, property of the estate shall be distributed--

* * * *

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection; and

* * * *

SECTION 1129 (11U.S.C. § 1129)

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

* * * *

(7) With respect to each impaired class of claims or interests--

(A) each holder of a claim or interest of such class--

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a **value, as of the effective date of the plan**, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan an account of such claim property of a **value, as of the effective date of the plan**, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

* * * *

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that--

(A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, each holder of a claim of such class will receive--

(i) if such class has accepted the plan, deferred cash payments of a **value, as of the effective date of the plan**, equal to the allowed amount of such claim; or (ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a **value, as of the effective date of the plan**, equal to the allowed amount of such claim.

* * * *

(b) (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides--

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a **value, as of the effective date of the plan**, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims--

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a **value, as of the effective date of the plan**, equal to the allowed amount of such claim; or

* * * *

(C) With respect to a class of interests--

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

* * * *

§ 1225. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if--

* * * *

(4) the **value, as of the effective date of the plan**, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan--

(A) the holder of such claim has accepted the plan;

(B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the **value, as of the effective date of the plan**, of property to be distributed by the trustee or the debtor under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; and

* * * *

(b) (1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, **as of the effective date of the plan–**

(A) the **value** of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

* * * *

SECTION 1322 (11 U.S.C. § 1322)

§ 1322. Contents of plan.

* * * *

(b) Subject to subsections (a) and (c) of this section, the plan may—

* * * *

(2) modify the rights of holders of secured claims, other that a claim secured only by a security interest in real property that is the debtor's principal residence....

* * * *

SECTION 1325 (11 U.S.C. § 1325)

§ 1325. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if--

(4) the **value, as of the effective date of the plan**, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan--

(A) the holder of such claim has accepted the plan;

(B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the **value, as of the effective date of the plan**, of property to be distributed under the plan on

account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; and

* * * *

(b) (1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, **as of the effective date of the plan**--

(A) the **value** of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

* * * *

TITLE 28, JUDICIARY AND JUDICIAL PROCEDURE

28 USCS § 157 (2002)

§ 157. Procedures

* * * *

(b) (1) Bankruptcy judges may hear and determine all cases under title 11 [11 USCS §§ 101 et seq.] and all core proceedings arising under title 11 [11 USCS §§ 101 et seq.], or arising in a case under title 11 [11 USCS §§ 101 et seq.], referred under subsection (a) of this section, and may enter

appropriate orders and judgments, subject to review under section 158 of this title [28 USCS § 158].

(2) Core proceedings include, but are not limited to--

* * * *

(L) confirmations of plans;

* * * *

28 USCS § 158 (2002)

§ 158. Appeals

(a) The district courts of the United States shall have jurisdiction to hear appeals[ ]

(1) from final judgments, orders, and decrees;

* * * *

28 USCS § 1254 (2002)

§ 1254. Courts of appeals; certiorari; certified questions

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

* * * *

28 USCS § 1334 (2002)

§ 1334. Bankruptcy cases and proceedings

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

APPENDIX F

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA

Case#99-13425-13

Indianapolis, Indiana
February 29, 2000
9:43 a.m. O'clock

IN THE MATTER OF;)
)
LEE AND AMY TILL)
)
Debtors.)
)

**** Excerpt ****

TRANSCRIPT OF CONTINUED HEARINGS ON:
(1) TRUSTEE'S MOTION TO DISMISS;
(2) OBJECTION TO CONFIRMATION FILED BY SCS CREDIT CORP., AND DEBTOR'S RESPONSE FILED THERETO
BEFORE THE HONORABLE FRANK J. OTTE, J.U.S.B.C.

**** Excerpt ****

APPEARANCES:

For the Debtors:

EDWARD KOHAN, ESQ.
217 Southway Boulevard
Kokomo, IN 46502

For SCS Credit Corp.:

JOHN SMITH, ESQ.
214 W. Marion Street
Elkhart, IN 46516

For the Chapter 13 Trustee:

ROBERT BROTHERS, ESQ.
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Electronic Sound Recording Operator: Cathy Ford

Proceedings Recorded by Electronic Sound
Recording Transcript Produced by Certified
Transcription Service

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[P. 9] In terms of what's out there now and the approaches being used in the appellate court system, I'm impressed mostly by the -- what appears to be a standard that possibly a majority of the courts are adopting, and that's the prime-plus standard that Judge Bayt used in his *Carson* decision -- decision back in 1998, and I think Judge Metz subsequently followed it, and that's simply computing the prime interest rate as of petition date -- not as of confirmation date, but a nice, easy, out-front date, easy for all to compute -- date of petition. When you're ready to file it you compute the prime and then add what historically these cases are treating as a one to three per cent additional risk factor in order to give the creditors some buffer against possible loss.

In this case, in *Carson* Judge Bayt pegged it at prime plus one and a half and adopted that as his future standard for

all automobile interest rates that would come before him, and I think Judge Metz has followed that. That has added simplicity in our ability to run our office, and it's something that is readily computable and I think works quite effectively.

The courts have noted that you don't really have to reward the creditor with a higher interest rate over and above what it would have to pay to borrow money, and I know the creditor before the Court today is seeking what I perceive to be kind of its standard lending rate or market rate of 21 per cent, but this is just one creditor with this rate. Many of [P. 10] our other lenders are substantially lower, so there appears to be little certainty when a debtor or debtor's counsel would attempt to prepare a petition as to what one would have to offer. Do you have to come up with a 21 per cent for this creditor, or can you go down the road -- ?

For instance, the other day I noticed Hubler Dodge, down at 3800 South East Street or South Madison, their market rate was absolutely zero finance charge, and they were doing that as part of a promotion, but that was their rate. So their -- in essence, with them you can walk into their dealership, compute the price of a brand new vehicle, divide it by 36 or 48 or 60 months, and that's your payment.

Without a standard other than market rate -- or with the market rate standard that I think the creditor seeks and I'd ask this Court to adopt, you're always going to be playing with something slipping and sliding around that the average counsel wouldn't be able to compute it. The prime plus is easily ascertainable on a daily basis, and it wouldn't work in a way to engage this Court in sort of a, what I think is a

frustrating search for what might be non-existent markets or non-existent similar loans that you would be dealing with.

The parties all look to the *Koopman's* case, Judge -it's the Seventh Circuit Chapter 12 case that came down some time ago to treat the interest factor that would be allowable. I really, probably for the first time -- I'd read *Koopman's* [P. 11] before but never gave it a hard read. I did it this morning, and I'm -- it's kind of amazing when you go through the ruling. They adopt the prime plus standard, yet within the same sentence state that the lender is entitled to its market rate of interest. You can't have it both ways. You simply can't. I think there must have been some confusion at that level.

At the close-out of *Koopman's*, though, I think one of the final lines that the Court, the Seventh Circuit level, said,

> "You simply have to read the cost of capital from newspaper tables, based upon actual transactions in competitive markets."

Well, I did that today. I pulled the newspaper and I looked at it, and the table I saw is prime. It's the only thing I could go by other than T-bill rates, which are lower, and I think probably no one has. Prime, as of today, for instance, is 8.75 per cent interest.

Now if you track the -- if you track the Judge Bayt decision in *Carson* you'd add one and a half points to that and you'd have a ten and a quarter loan, easily computable when you sit down and meet with the debtor and put together a plan and yet gives the creditors some hedge factor on its risk. I

think it's a good idea, and I think it's an appropriate standard to adopt.

The auto lender further has other built-in...

[P. 23] THE COURT: Well, you feel free when you want to, Mr. Brothers. Counsel may examine.

MR. KOHAN: Thank you.

DIRECT EXAMINATION

BY MR. KOHAN:

Q. Please state your name for the Court.

A. Steve Russell.

Q. And where are you employed?

A. I'm the Professor of Economics at IUPUI.

Q. Would you go through your employment history a little bit?

A. Yeah, I've had a -- got a Ph.D. from the University of Minnesota. I taught at the University of Georgia for four years. I worked as an economist in the research department of the Federal Reserve Bank of St. Louis for three years, and I've been at IUPUI for six or seven years.

Q. What are you currently teaching?

A. The course that I teach the most frequently is Money and Banking.

Q. Okay. Thank you. Let me ask you this generally, what's the purpose of the prime rate? Why do banks and other lending institutions use that as a benchmark in computing interest rates, or starting at least off on interest rates?

A. Well, the prime rate is a rate that banks charge on loans to their most credit-worthy corporate customers, and it's part of a uniform national market, so it's a uniform rate across the [P. 24] country. So it's easy to point out, you know, the rate on this particular class alone is going to be the same in California as in New York or anywhere else in the country, so it's a benchmark, a national benchmark rate.

Q. Okay. Does that generally take into account the change in the value of the dollar? Or maybe if you want to get into what this whole concept of the changing value of the dollar?

A. Yeah, there's three or four things in the prime rate that are also in any other market interest rate of varying degrees. There's an adjustment for the change in the purchasing power of the dollar, or the inflation rate. Right now that's probably two and a half per cent or so. There is an adjustment for the fact that something you referred to that people prefer dollars now to dollars later, and so a dollar now is a little more valuable than a dollar later, even if there is no risk that the dollar won't be repaid. And that -- that number right now is probably roughly three and a half per cent. That's the difference between the inflation rate and the interest rate on a very safe loan to the federal government, a Treasury bond, okay?

So that would take us up to roughly six per cent, which was the Treasury rate on comparable loans, I think, at the time of this bankruptcy filing. The prime rate was, at the time was closer to eight per cent, and that two per cent is mostly, I think, risk to some extent transactions costs. There [P. 25] is some risk on these loans, even though they're to pretty credit-worthy firms, because in most cases they're not secured, which makes them different from, say, a car loan.

Q. Mmhmm.

A. There's no explicit collateral on most of these loans.

Q. So generally, the loans that are secured, let's say you said car loans are -- have lower interest rates than unsecured, let's just say credit card loans?

A. Right. What matters is what the lender is likely to get in the event of a default, and obviously he's likely to get much more on a secured loan than on an unsecured loan. On an unsecured loan it's possible to get nothing, and often happens.

Q. So they get some of the collateral and at least get some of their costs back.

A. Right.

Q. Okay. What, in your opinion, generally speaking, what are some of the facts -- other factors that go into interest rate? You could look at prime rate, but obviously not if you want to use it as prime rate. What else is it -- what else -- what's the main factor that goes into -

A. Yeah, if you look at interest rates on loans, you know, that have rates above the prime interest rate, which most loans do, probably the single biggest determinant of the interest rate is the risk on the loan over and above the risk on one of these loans to a corporation that presumably is a very good [P. 26] credit risk. There is also an adjustment for the transactions costs of making a loan, which can include things like legal costs. I could include overhead for providing the facilities to have people come in and borrow, so there is a variety of different costs involved in making loans, and those are different, for different classes of loans, and so higher for some, lower for others.

Q. Let me ask you this: Based on what you've heard and what's been presented, would you feel that a nine and a half per cent interest rate is a reasonable interest rate for this -- for an auto creditor, given the present value of their claim?

A. "Yeah, I guess -- I would think that nine and a half was plenty. I looked at the interest rate, the current average interest rate in the United States on new car loans. Now this is a used car loan, so you might want to add a little bit to that rate, but it was roughly eight and a half per cent, so actually interest rates on car loans are pretty low. Again, the -- close to the prime rate because the security provided by the car kind of offsets the fact that these are loans to very credit-worthy firms.

Q. Mmhmm.

A. So the additional one and a half per cent, you know, in the prime plus one and a half, I guess you could interpret as an adjustment for the fact that the transactions costs of [p.

27] making small loans to people to buy cars are higher than the costs of making big loans to General Motors or whatever. And so it seems like a very reasonable rate. So with the understanding that the risk on making the loan is fairly limited because the borrowers are under the supervision of the court and are working with a plan that's supposed to be financially feasible, et cetera, et cetera.

MR. KOHAN: Okay. Thank you very much. I'm done, Your Honor.

THE COURT: Mr. Smith, cross-examination, sir.

MR. SMITH: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. SMITH:

Q. Sir, have you ever worked for a creditor?

A. I actually have worked for a commercial bank briefly, before I went to graduate school

Q. And when was that?

A. That was when I was an undergraduate -- would have been in the late 1970s, early 1980s.

Q. Okay, are you familiar with the particular credit criteria that any individual banks use in determining when to make a loan to particular customers or applicants?

A. Well, not in any degree of detail. I mean, I know the factors that are involved, but I wouldn't know how any particular creditor would assess those factors.

[P. 32]

A. Because the typical customers that we sell cars to have poor credit histories and are risky customers.

Q. Are you familiar with the credit history of the debtors and other relevant characteristics?

A. Yes.

Q. Is the credit history and the credit characteristics of the debtors similar or typical of the types of customers that Instant-Auto Finance typically sells to?

A. Yes.

Q. What was the rate of interest that Instant-Auto Finance charged the debtors when this vehicle was sold?

A. 21 per cent.

Q. What is the rate of interest typically charged by Instant-Auto Finance?

A. 21 per cent.

Q. Does Instant-Auto Finance ever sell vehicles on credit other than to employees for a rate of interest of less than 21 per cent?

A. No.

Q. Based on your job experience in the industry are you aware of the interest rate charged by other similar lenders in this area?

A. Yes.

Q. And what is -- what is that rate of interest?

A. 21 per cent.

[P. 33]

Q. How does Instant-Auto Finance view a credit applicant who appears to be a candidate for a Chapter 13 bankruptcy petition?

A. Negatively.

Q. Are you aware of how other lenders similar to Instant-Auto Finance view credit applicants who appears to be candidates for 6 Chapter 13 bankruptcy?

A. Negative as well.

Q. And would your answer be the same if I were to ask you how Instant-Auto Finance or other similar lenders view applicants -- credit applicants who are actually in a Chapter 13 proceeding?

A. Yes.

MR. SMITH: I have no further questions, Your Honor.

THE COURT: Cross-examination of this witness?

CROSS-EXAMINATION

BY MR. KOHAN:

Q. You decide whether or not to give credit to particular negative particular people, right?

A. Right.

Q. Do you actually decide on an interest rate? I mean I understand it's always 21 per cent. Is that something that you made the call, or does someone else make that call at 21 per cent?

A. Someone else makes that call.

Q. So is it set by someone higher up in the company? Is that [P. 34] it?

A. Yes.

Q. So you really -- you don't know where they come up with that 21 per cent. It's just something they told you you charge people with bad credit.

A. I believe it's what the market will bear.

Q. Well -- but I mean you don't know how they determined that 21 per cent interest, is that correct?

A. Correct.

Q. Okay. You may have heard these arguments, a lot of references to present value. Do you understand what present value means in the bankruptcy sense or the economic sense?

A. No.

MR. KOHAN: Okay. Thank you.

MR. SMITH: No further questions, Your Honor.

THE COURT: You may step down, sir. Any further witnesses?

MR. SMITH: Yes. One more, Your Honor. Neil Bird.

NEIL BIRD, LENDER'S WITNESS, DULY SWORN

THE COURT: All right, sir. Please have a seat, state your name for the record.

THE WITNESS: My name is Neil Bird.

THE COURT: Counsel may examine.

MR. SMITH: Thank you, Your Honor.

DIRECT EXAMINATION

[P. 35]

BY MR. SMITH:

Q. What's your address; Mr. Bird?

A. 1722 Bader Avenue, South Bend, Indiana.

Q. And where are you currently employed?

A. SCS Credit Corp.

Q. And how long have you been employed there?

A. Four years.

Q. And what is your job title or your position there?

A. I'm the general manager of SCS.

Q. Does that involve overseeing collections of accounts?

A. Yes, it does.

Q. Where did you work before you were employed by SCS Credit Corp.?

A. Teachers' Credit Union.

Q. How long did you work there?

A. Nine years.

Q. You've heard some of the testimony today about prime and non-prime lending markets. How would you characterize SCS Credit Corp.?

A. We're a non-prime lender.

Q. How would you characterize Teachers' Credit Union, your employer of nine years before coming to work for SCS Credit Corp.?

A They were a prime lender.

Q. Does SCS take assignment of retail installment contracts [P. 36] from Instant-Auto Finance?

A. Yes, we do.

Q. And is that what happened in this particular case with the debtors --

A. Yes.

Q. -- and the contract that they signed?

A. Yes, it is.

Q. Are you familiar with the credit history and the credit characteristics of the debtor?

A. Yes.

Q. Are the credit history and credit characteristics of the debtors similar to other customers that SCS Credit Corp. takes assignment of --

A. Yes, is it.

Q -- on a retail installment contract basis?

A. Yes.

Q. What is the rate of interest on the retail installment contract that SCS takes assignment of?

A. Twenty-one per cent.

Q. Is that always the case with non-employers? Are there ever any exceptions made?

A. No, there's not.

Q. And what is the rate of interest that the debtors agreed to on this particular retail installment contract?

A. Twenty-one per cent.

[P. 37]

Q. How does SCS Credit Corp. view Chapter 13 bankruptcy petitions?

A. We do not like them.

Q. Why not?

A. Because usually we don't get paid the full plan for the vehicle.

Q. Okay. Is there any delay in receiving the money?

A. Yes, there is.

Q. Do -- do Chapter 13 debtors ever enter into a plan and then SCS Credit Corp. actually never receives any distributions under the plan for one reason or another?

A. Yes, that's correct.

Q. Do you know how other non-prime lenders view Chapter 13 bankruptcy petitions, both with respect to potential applicants or customers that they already have on their books when a Chapter 13 petition is filed?

A. They're the same as SCS. They do not like them.

MR. SMITH: Okay. I have no further questions.

THE COURT: Cross.

CROSS-EXAMINATION

BY MR. KOHAN:

Q. Do you con -- do you set interest rates for SCS? Do you--

A. No, I do not.

Q. -- do you control that? So again, that comes from the higher-up in the company, I take it -...

APPENDIX G

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

Case#99-13425-FJO-13
CHAPTER 13

[Filed January 19, 2000]

IN RE:Till, Lee Madison	)
312-78-7180	)
Till, Amy Helen	)
313-98-1051	)
	)

AMENDED CHAPTER 13 PLAN

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE OF SAID COURT:

COMES NOW, Lee Madison Till and Amy Helen Till, Debtor(s) herein, and proposes the following plan under Chapter 13 of the Bankruptcy Code:

1. The debts of DEBTOR(S) duly proved and allowed to shall be paid to the holder thereof in accordance with the provisions of Chapter 13 of the Bankruptcy Code and this Plan:

2. The future earnings of DEBTOR(S) are submitted to the supervision and control of this Court, and DEBTOR(S) shall pay tot he TRUSTEE a sum of $740.00 per month in weekly installments by voluntary wage assignment by separate ORDER of the Court in an estimated amount of $170.77 and continuing for a total plan term of 36 months unless this Court approves an extension of the term not beyond 60 months from the date of filing the Petition herein.

3. From the payments received, the TRUSTEE will make disbursements in the following order:

(a). *Administrative Expenses:* The TRUSTEE shall FIRST pay the expenses as prescribed by the Court, for administering of this plan. Expenses do not include an attorney fee as the DEBTORS qualify for benefits under their Pre Paid Legal Services Program and no fees are charged for services in this case.

(b) *Priority Claims:* All Claims entitled to Priority under Section 507 of the Bankruptcy Code will be paid as follows:

Creditor: Internal Revenue Service
Claim Amount Estimated: $2,582.00
Interest: Statutory interest

(c). *Secured Claims:* Secured creditors, whose claims are duly and timely filed, approved and allowed will be treated as follows:

(1). *Valuation of Collateral:* The Creditors listed below have a claim secured by a lien on the collateral shown

and the claim of each such creditor is secured to the extent of the fair market value of such property. The value of such creditor's interest is such collateral is as set forth herein below and such fair market value of such property is binding as to each creditor. The purpose of this plan provision and the valuation is to clearly provide that once Debtor(s) have paid such fair market value through the TRUSTEE, the lien of each such secured creditor shall be deemed invalid and satisfied, and at such time, each creditor shall immediately execute and deliver any and all necessary documents to effectuate release of such lien and delivery of an unencumbered title to the Debtor(s). Each creditor herein shall retain its lien existing prior to the commencement of this case only to the extent of the value of its collateral to secure payment as outlined herein.

Creditor: Ace Financial
Claim Amount: $8,500.00
Interest: 9.5%

Creditor: Heilig-Meyers Furniture
Claim Amount: $50.00
Interest: 0%

Creditor: Radio Shack Credit Card Plan
Claim Amount: $75.00
Interest: 0%

Creditor: SCS Credit Corporation
Claim Amount: $4,225.00
Interest: 9.5%

(2). *Payment of Secured Claims:* Secured claims duly and timely filed and allowed will be paid current with all above classes of creditors pro rata.

(3). *Void Liens:* The secured creditors listed below hold a non-purchase money, non-posserory security interest on Debtor(s) exempt property. Their liens will be voided pursuant to 11 U.S.C. section 522(0 and their claim treated as unsecured and paid pursuant to paragraph (e) below:

Creditor: Heilig-Meyers Furniture Co.

(d) *Special Class:* The following specially classified claims shall be paid as follows:

NONE

NONE

(e) *Unsecured Creditors:* Unsecured claims will be paid by the TRUSTEE after payments of the aforementioned categories, to creditors who have duly and timely filed and proved their claim, with the same having been allowed by the Court, with such payments or dividends to be paid in lieu of the debt and in satisfaction of the debts of such creditors.

(f) No interest, penalty or additional charge shall be allowed on any account subsequent to the filing of the petition herein, except that interest shall be allowed on claims to fully secured creditors in accordance with 11 U.S.C. section 506(b).

4. Debtors shall pay direct the following debts outside the Plan:

Creditor: Rent-A-Center
Claim: $6,600.00

5. The following secured claims are not dealt with in the Debtor(s) Plan, therefore, upon confirmation of the Debtor(s) Chapter 13 Plan, the automatic Stay Provisions of 11 U.S.C. section 362 will be terminated and annulled with respect to each of the following claims:

NONE

The remaining portion of the debt (deficiency) of the above listed creditors under paragraph 5 shall be disallowed as a claim as the collateral is being surrendered in full satisfaction of the debt.

(6). All executory contracts of the Debtor(s) will be assumed unless specifically rejected herein. The following executory contracts and/or leases are assumed or rejected as indicated below:

Creditor: Bradford Run Apartments
Contract is: Rejected

Creditor: DMA Enterprise
Contract is: Assumed

Creditor: Maple Crest Apartments
Contract is: Rejected

Creditor: Rent-A-Center
Contract is: Assumed

(7). Upon confirmation of this plan, title of the property of the estate shall vest in the Debtor(s).

(8). The funding of this plan will include federal tax refunds if due in an amount not to exceed one half of said refund over the base amount of $500 allowed to the debtor(s) as a cushion amount yearly if said is received. The debtor agrees to provide a copy of the tax return filed in the year immediately following the confirmation of this Plan by April 15th of the said following year and each year thereafter during the term of this Plan.

Date: 13 Jan 00 Debtor: /s/Amy H. Till

Date: 13 Jan 00 Debtor: /s/ Lee Till

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(2)

No. 02-1016

In the Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

PETITIONERS' SUPPLEMENTAL BRIEF

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Petitioners file this supplemental brief in support of their Petition for Writ of Certiorari to demonstrate how the Sixth Circuit Court of Appeals decision in *In re Kidd*, 2003 U.S. App. LEXIS 188 (6th Cir. 2003) (App. H at 82a) entered January 8, 2003 deepens the split amongst the Circuits and raises new questions regarding the continued validity of several Circuit decisions that had misconstrued early Sixth Circuit precedent. Because the Sixth Circuit was the first Circuit to adopt a "coerced loan" approach, all subsequent "coerced loan" Circuits were influenced to some degree by what the Sixth Circuit in *Kidd* exposes as an improper expansion of the "coerced loan" and "market rate" concepts.

MOST RECENT CIRCUIT DECISION ADDS TO CONTROVERSY

I. Sixth Circuit in *Kidd* Clarifies That "Market Rate" Concept Was Never Intended to Require Fact-Specific Inquiry Nor Contract Rate of Interest in Cramdown Context

Memphis Bank & Trust Co. v. Whitman, 692 F.2d 427 (6th Cir. 1982) was the first Circuit Court opinion addressing the methodology for determining the cramdown interest rate under 11 U.S.C. § 1325(a)(5)(B)(ii). According to the Court in *Memphis Bank,* the creditor under the cramdown statute makes a new or coerced loan to the debtor in the amount of the current value of the collateral, and the most appropriate interest rate is therefore the current market rate for similar loans at the time the new loan is made. In so ruling, the Court in *Memphis Bank* provided little practical guidance to courts in determining how the appropriate "market rate" should be determined.

The decision of the Sixth Circuit in *Kidd* required interpretation of what the Court considered the "controlling case" of *Memphis Bank* (App. H at 83a). The debtors'

contract for purchase of a used vehicle in *Kidd* provided for payment of interest at the rate of 20.95%, as compared to the 8% rate of interest proposed by the debtors' Chapter 13 plan (App. H at 85a). Creditor Household Automotive Finance Corporation submitted evidence of its status as a "subprime" lender, and testimony that the debtors would not qualify for an interest rate of less than the 20.95% contract rate as a result of their poor credit standing. The bankruptcy court instead accepted (as credible evidence of "market rate") the testimony of a local bank president who testified to a weighted average rate of interest of 9.3% for all car loans (both new and used vehicles for all tiers of borrowers) (App. H at 86a). Although the bankruptcy judge found from the evidence presented that "the current market rate for similar loans in the region is 9.3%," the bankruptcy court fixed the rate to be applied to the Kidds' loan at 10.3%, as a result of a recent rise in interest rates (App. H at 87a). In upholding the bankruptcy court's determination, the Court of Appeals concluded that the proper rate of interest to be applied in a Chapter 13 cramdown is:

> ...the current conventional market rate used for similar loans in the region, and not necessarily the contract rate. Such a determination does *not* entail an analysis of any particular debtor's credit rating but rather involves a more objective determination of the value of money over time so as to compensate a creditor according to the present value of its secured claim.

(App. H at 96a) (emphasis added).

Household relied upon the early Sixth Circuit case of *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989), where the Court of Appeals, interpreting *Memphis Bank*, held that

"where a 'cramdown' occurs..., a creditor is entitled to *its* current *market rate* on the 'new loan'" (emphasis added). 878 F.2d at 930. Household contended that the Court's reference to "its market rate" in *Arnold* mandates fixing of interest at the rate at which a loan would be made by Household as a "subprime" lender to borrowers with poor credit standing identical to that of the debtors in *Kidd*.

The Court of Appeals in *Kidd* firmly rejected the fixing of a rate based upon such a creditor-debtor specific inquiry as follows:

> In fact, adoption of such a rate is tantamount to endorsement of the automatic application of a contract rate of interest, a principle clearly at odds with the clear language of *Memphis Bank & Trust*. Rather, it is more likely that use by the panel in *Arnold* of the modifier 'its' to describe the appropriate market rate was intended solely to limit consideration to rates relevant to the particular *types of loans* at issue. For instance, the setting of the market rate for automobile loans should be limited to consideration of only the automobile loan universe and not rates that would apply to an average borrower seeking, for instance, financing for a new home.

(App. H at 92a-93a)(emphasis in original).

The *Kidd* case is thus significant in two key respects. First, the Court of Appeals in *Kidd* finally dispelled the notion that the Sixth Circuit in *Memphis Bank* and *Arnold* intended application of a fact-specific interest rate that can be determined only on a case-by-case basis from information specific to a particular debtor or creditor. Second, the Court of Appeals in *Kidd* flatly rejected the creditor's contention

that *Memphis Bank*, *Arnold,* or *In re Colegrove*, 771 F.2d 119 (6th Cir. 1985), provide support for application of the contract rate of interest on an undersecured creditor's claim in the cramdown context.[1] The Sixth Circuit in *Kidd* recognized that application of "present value" payments by use of a discount factor does not derive from any state-law "contractual" obligation, but results instead from a statutory adjustment for the "time value of money" due simply to the debtors' deferred payment.

II. *Kidd* Decision Calls Into Question Continued Viability of Numerous Circuit Decisions Which Have Misconstrued Sixth Circuit Precedent

Because *Memphis Bank* was the first Circuit decision to adopt a "coerced loan" approach, most, if not all, subsequent Circuit decisions adopting a "coerced loan" approach can be traced back to the *Memphis Bank* decision -- and to what has now been exposed by the Sixth Circuit as an erroneous construction of that and subsequent Sixth Circuit cases.

The majority panel in *Till* patterned its decision after the Third Circuit decision in *GMAC v. Jones*, 999 F.2d 63 (3rd Cir. 1993). *Jones*, in turn, adopted *Memphis Bank* as the

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[1] The Court interpreted the *Colegrove* case to be strictly limited to the facts of that case involving a completely secured home mortgage arrearage. The *Colegrove* case was subsequently superseded by enactment of the Bankruptcy Reform Act of 1994 and 11 U.S.C. § 1322(e), which limits the circumstances under which interest can be required to be paid on mortgage arrearages cured under a Chapter 13 plan. Cases relying upon *Colegrove* as grounds for imposition of contractual interest under the cramdown statute have thus been abrogated by statute.

pivotal case in which the "Sixth Circuit ... stated tersely ... the basic idea of the 'coerced loan' theory." 999 F.2d at 67-68. The Sixth Circuit's narrow interpretation of the *Memphis Bank* decision in *Kidd* to preclude a presumption in favor of the contract rate lies in sharp contrast to the Third Circuit's expansive interpretation in *GMAC v. Jones,* where the Court of Appeals adopted the contract rate presumption by erroneously interpreting *Memphis Bank* to require that present value be determined from facts specific to the creditor. According to the Court in *GMAC v. Jones:*

> ...the appropriate rate is that charged by the particular creditor forced to extend credit. If that creditor receives interest at a rate equal to the rate it charges in the regular course of its business in the region for loans of similar character, amount and duration, that creditor will be placed in approximately the same position it would have occupied had it been able simply to repossess the collateral at the time of the bankruptcy.

999 F.2d at 68, citing *Memphis Bank*, *supra*, 692 F.2d at 429.[2]

---

[2] In stark contrast to *GMAC v Jones'* reading of *Memphis Bank* to focus on a particular creditor's return on its investment, the Sixth Circuit in *Kidd* makes clear that the *Memphis Bank* "market rate" analysis instead contemplated an "objective" determination of the "value of money over time" so as to compensate a creditor for the "present value" of its secured claim (App. H at 96a) -- a clear directive by the Court of Appeals to shift focus away from the creditor's profit and lost opportunity costs back to the language of the cramdown statute.

The effect of misapplication of the decades-old *Memphis Bank* case has been far-reaching. Virtually all courts adopting a "coerced loan" approach prior to *Kidd* interpreted *Memphis Bank* and its progeny to require a creditor-debtor-specific inquiry with focuses upon the creditor's return on investment. A common description of the "coerced loan" approach from *Koopman's v. Farm Credit Services of Mid-America, ACA*, 196 B.R. 425 (N.D. Ind. 1996), *aff'd*, 102 F.3d 874 (7th Cir. 1996), gives some indication of the number of Circuits whose decisions are undermined by this common misconstruction of *Memphis Bank* and its progeny:

> ....Under [the coerced loan] approach, the bankruptcy court should look at the *creditor's cost of making a new loan to the debtor* in the amount of its allowed claim, *including a profit factor*, and use the current market rate for similar loans (loans of similar character, amount and duration) made in the region. *See General Motors Acceptance Corp.*, 999 F.2d at 67-70; [] *United Carolina Bank v. Hall*, 993 F.2d at 1130-1131; *In re Fowler*, 903 F.2d at 698; *In re Hardzog*, 901 F.2d 858, 860 (10th Cir.1990); *United States v. Arnold*, 878 F.2d 925, 930 (6th Cir.1989); *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 [] (8th Cir. 1986); *Matter of Southern States Motor Inns, Inc.*, 709 F.2d 647, 651-652 (11th Cir. 1983), *cert. denied*, 465 U.S. 1022, 79 L.Ed.2d 680, 104 S.Ct. 1275 (1984); *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427,431 (6th Cir. 1982).n9

196 B.R. at 427-28 (emphasis added) (footnote omitted).

Similar misinterpretations of *Memphis Bank* and *Arnold* can be found throughout the "coerced loan" Circuits. Thus, the Fourth Circuit in *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993), citing *Memphis Bank* and *Hardzog*, *supra*, concluded that the value of the collateral retained by the debtor under the Chapter 13 cramdown provision must be treated as a new loan which must "match its rate of return to the secured creditor with that which the creditor would otherwise be able to obtain in *its* lending market." 993 F.2d at 1130 (emphasis added).

Those Circuits (like the majority below) adopting a presumption in favor of the contract rate of interest have carried this misconstruction to an extreme. Thus, the Fifth Circuit in *Matter of Smithwick*, 121 F.3d 211, 213-14 (5th Cir. 1997) cited the above language from *Memphis Bank* and relied upon *United Carolina Bank v. Hall, Hardzog*, and *GMAC v. Jones* in adopting the Third Circuit's "coerced loan" approach of a rebuttable presumption in favor of the contract as the rate most consistent with what a particular secured creditor would charge for a loan similar in character, amount and duration to the "credit" extended to the debtor under the plan.

By imposing a "subprime" lender's contractual rate of interest as the presumptive cramdown rate under the guise of the "coerced loan" theory, the majority panel in *Till* and the Courts in *Smithwick* and *GMAC v. Jones* have created a stringent requirement for confirmation that was neither foreseen by the Court of Appeals in *Memphis Bank*, [3] nor sanctioned by the Bankruptcy Code.

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[3] Recall that the Court of Appeals in *Kidd* rejected the automatic application of the contract rate of interest as "a principle clearly at odds with the clear language of *Memphis Bank & Trust*." (App. H at 92a-93a).

III. Sixth Circuit in *Kidd* Leaves Many Questions Unresolved

The *Kidd* case is important in clarifying that the "coerced loan" theory as first enunciated in *Memphis Bank* was never intended to address a particular creditor's status as a "subprime" lender, or a particular debtor's poor credit rating. Yet, in having to work within the confines of the "coerced loan" theory, there are many questions that the Court of Appeals in *Kidd* could not adequately resolve.

The Court of Appeals in *Kidd* wholly fails to address the fact that the conventional bank loan (which served as the basis for the rate adopted by the Court) would necessarily include the costs of a new loan transaction [not incurred under § 1325(a)(5)(B)(ii)], as well as profit earned in a conventional bank loan transaction (inapplicable to the statutory "present value" inquiry).

Although the Court of Appeals in *Kidd* thus went a long way in attempting to limit the damage that has occurred through improper extension of the "coerced loan" theory, the Court could not go far enough as a result of the "precedential deference" it was constrained to accord *Memphis Bank* and its progeny (App.H at 96a). The Court in *Kidd* thus presumed from *Memphis Bank* that a "market-rate" approach was required, and that a "market" existed, despite the fact that nothing in the statute supports the application of a "market-rate" analysis for determination of the "present value" discount factor. The result is an arbitrary application of a conventional bank loan rate that includes improper elements of profit that cannot be reconciled with the statutory time-value-of-money concept.

Nor does the Court of Appeals in *Kidd* address the implications of this Court's intervening decision in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997) seemingly

at odds with the "coerced loan" approach, as a result of the windfall afforded the creditor by payment of an inflated interest rate on the replacement value of the collateral -- based on the fiction of a creditor repossessing its collateral and reinvesting its proceeds. The Court in *Kidd* instead confined its analysis to "[t]he principles of valuation espoused in the case of *Memphis Bank*..." (App. H at 96a).[4]

Constrained by *Memphis Bank's* use of the "coerced loan" theory, the Court of Appeals in *Kidd* attempts to limit the discrepancy between "market rate" and "present value"[5] by interpreting *Memphis Bank* to sanction use of conventional market rates of interest rather than "subprime" rates for high-risk borrowers. But the Court could go no further in exploring whether the use of the conventional bank loan rate with an arbitrary add-on was in fact true to the language of the cramdown statute and the historic concept of "present value."

Nor does the Court of Appeals in *Kidd* address the effect of this Court's intervening decision in the case of *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), which has been construed to deny payment of interest to undersecured creditors as

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[4] It was unclear what methodology was used by the Court of Appeals in *Memphis Bank* to value the allowed secured claim, which in part resulted in reversal and remand of the case to the bankruptcy court for further proceedings. 692 F.2d at 430-31. The possible effect of use of a *Rash* replacement valuation under the *Memphis Bank* analysis thus remains subject to debate.

[5] The Court in *Kidd* thus avoided the egregiousness of the *Till* analysis resulting in the fixing of a 21% "present value" discount factor, despite the fact that both Courts purported to adopt a forced loan market rate analysis--again demonstrating the serious lack of uniformity inherent in the "coerced loan" approach.

compensation for profit or lost investment opportunities pending receipt of deferred payments under a reorganization plan.

In attempting to conform the present value calculation to the decades-old *Memphis Bank* decision, the Court of Appeals in *Kidd* thus left a string of Circuit Court decisions in disarray, and failed to address intervening decisions of this Court that may significantly affect the cramdown interest rate determination.

CONCLUSION

Petitioners respectfully request that their Petition for Writ of Certiorari be granted to resolve the split between the Circuits that is now more pronounced as a result of the analysis undertaken by the Sixth Circuit in *Kidd*. The fact that so many questions were left unresolved by the Court of Appeals in *Kidd* makes clear that only the Supreme Court can adequately address the issues presented by the *Till* Petition, and reconcile the conflicting analyses of the numerous Circuits to have addressed the cramdown interest rate issue.

Respectfully Submitted,

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APPENDIX H

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 01-5074

[Filed January 8, 2003]

In re: LEWIS KIDD and ROBERTA KIDD, Debtors	)
HOUSEHOLD AUTOMOTIVE FINANCE CORPORATION, Appellant	)
v.	)
BEVERLY BURDEN, Trustee, Appellee	)

Appeal from the United States District Court
for the Eastern District of Kentucky at Pikeville
No. 00-00400
Joseph M. Hood, District Judge

Before: DAUGHTREY and MOORE, Circuit Judges;

SIMPSON, District Judge.*

OPINION

MARTHA CRAIG DAUGHTREY, Circuit Judge. In this bankruptcy appeal, we are asked to review the bankruptcy court's calculation of the appropriate interest rate to be applied in a "cram down" provision in the debtors' Chapter 13 plan. The decision requires interpretation of language in the controlling case of *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427 (6th Cir. 1982). There we adopted what has since become known as the "coerced loan" formulation in the application of 11 U.S.C. § 1325(a)(5)(B), which is the Chapter 13 provision that has been held to permit confirmation of a plan proposed by the debtor over the objection of the holder of a secured claim. Here, the sales contract for the debtors' pickup truck imposed an interest rate of 20.95%, allegedly due to the purchasers' poor credit rating. The Chapter 13 plan proposed a rate of 8%, and the trustee suggested a rate of 10-11%. The bankruptcy court determined that the rate should be 10.3%, an amount that the district court affirmed as reasonable under the circumstances. The creditor now appeals, insisting that in this case only the contract rate will satisfy the valuation criteria of § 1325(a)(5)(B). We reject this contention as a legal proposition and, giving the bankruptcy court's decision what we believe to be the substantial degree of deference required in this context, we find no error and affirm.

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* The Honorable Charles R. Simpson III, United States District Judge for the Western District of Kentucky, sitting by designation.

FACTUAL AND PROCEDURAL BACKGROUND

The relevant facts germane to this dispute are not contested by the actual parties to the appeal, Household Automotive Finance and the Chapter 13 Trustee. Indeed, much of the background evidence adduced at the hearings in this matter was introduced by way of joint stipulation. As noted by the bankruptcy court, the parties agreed upon the following facts:

1. Debtors entered into a Retail Installment Contract and Security Agreement dated May 11, 1999 (the "Contract") under the terms of which Debtors purchased a 1996 Chevrolet C1500 Pickup Truck (the "Vehicle") from Myers Chevrolet-Oldsmobile-Cadillac, Inc. (the "Dealer") for an agreed price of $ 16,827.00.

2. The contract was assigned by the Dealer to Household Automotive Finance Corporation ("Household"), which accepted the assignment.

3. Household has a first and prior lien on the Vehicle by virtue of the Title Lien statement filed in the Perry County Clerk's office on May 20, 1999.

4. Pursuant to the Contract, the balance of the purchase price in the principal amount of $ 14,767, plus interest at the rate of 20.95%, was to be paid by Debtors in 60 monthly installments of $ 399.08.

5. Debtors made two payments under the Contract before filing their Chapter 13 Petition (the "Petition") on August 16, 1999.

6. Debtors filed their Plan along with the Petition under which Debtors proposed to pay 8% interest on the allowed secured claim of Household under the Contract.

7. Household filed its Proof of Claim on September 9, 1999, setting forth a secured claim amount of $ 14,796.85.

8. The value of the Vehicle for purposes of confirmation of the Plan is $ 13,900.

The parties' agreement that the vehicle had a present value of only $ 13,900 thus resulted in Household having a secured claim against the Kidds in that amount and an unsecured claim in the amount of $ 867, which represents the difference between the total amount financed and the value of the collateral. Despite the consensus on the value of the collateral, Household vigorously contested the proposed interest rate to be applied to the payment to the finance company as a secured creditor, arguing that it was entitled to the full 20.95% interest rate rather than the 8% rate proposed by the Kidds. Given that disagreement, the bankruptcy judge conducted an evidentiary hearing at which three witnesses offered opinions as to the appropriate market rate of interest that should be added to the installment payments for the debtors' truck.

David Clayton Cruise, III, the regional sales manager for Household, explained that Household was considered a "subprime" lender because it offered loans to individuals whose past credit problems or lack of positive credit history made them unattractive customers for banks, credit unions, and other "prime" lenders. Due to the higher risk of non-payment from those borrowers, Cruise testified, sub-prime

lenders generally charged higher rates of interest on their loans, ranging from 20.95% to 24.95% for automobile loans. Cruise did admit, however, that Household's website advertised loans at rates as low as 10.95%. He nevertheless insisted that the Kidds, as a result of their low scores on charts predicting creditworthiness, would not be offered an interest rate by Household less than the contract rate of 20.95%.

The second witness to testify at the evidentiary hearing, Richard Newsome, served as senior vice-president and division manager for consumer lending at Community Trust Bank in the Pikeville, Kentucky, area. He explained that the bank rate of interest for a high-risk borrower purchasing a 1996 pickup truck would be 16.25% and the average rate for all used truck loans would be 13.5%. Pursuant to questioning by the Chapter 13 trustee, however, Newsome indicated that a "weighted average" rate for *all* car loans, for both new and used vehicles, and for all tiers of borrowers, would be 9.3% because "99% of those people [in the entire universe of borrowers] pay."

Finally, Michael Litzinger, an attorney in the office of the Chapter 13 trustee, testified that hearings to determine the proper interest rate to be applied in situations similar to the one before the court were seldom required because all parties usually agreed on the application of rates between 10% and 11%. In fact, Litzinger claimed, Household itself had recently agreed to eight different Chapter 13 plans with automobile interest rates of 8% and two plans calling for rates of 10%. The witness concluded that interest rates approved in plans in that area of Kentucky generally ranged from 8-12%. Specifically, he explained:

> Seven percent has almost always drawn objection. Eight percent will on occasion draw an objection and has done so lately because the interest rate in the market is going up in the last year or so. Ten and ten and a half don't draw that many objections. Eleven rarely does and twelve almost never. Some debtors' accounts have 12 for the sole purpose to make sure that they don't get an objection and it's accepted and I think that's why they do that.

Faced with the divergent testimony of the witnesses at the hearing, the bankruptcy judge found the testimony of Richard Newsome, the bank vice-president, believable and determined that the testimony "that the rate of interest for car loans that are made by his bank in the region is 9.3%, is credible evidence of the market rate of interest." The judge specifically found that Cruise's testimony that the market rate of interest is 20.95% "is not entirely accurate," especially in light of the fact that Household advertises rates on the internet as low as 10.95% and has agreed in other Chapter 13 cases to interest rates of 8% and 10%.

Consequently, the bankruptcy judge found "that the current market rate for similar loans in the region is 9.3%," but that, because interest rates had experienced a recent rise, the rate to be applied to the Kidds' loan should be 10.3%. Both Household and the Kidds appealed that decision to the district court, Household arguing that its contract rate of 20.95% should have been used to arrive at the present value of the collateral, and the Kidds contending that no interest whatsoever should be added to the resale value of the pickup truck. The district judge, however, affirmed the ruling of the

bankruptcy court, concluding that the finding of a 10.3% market rate was not clearly erroneous. Additionally, the district court declined to analyze the propriety of the bankruptcy court's consideration of other Chapter 13 plans involving claims by Household, stating that any error in that regard would be harmless because "there is sufficient evidence in the record which supports his conclusion regardless of these agreed orders." Household now appeals from that ruling, availing itself of another opportunity to challenge the conclusion reached by the bankruptcy court.

DISCUSSION

I. Standard of Review

As noted in *Borock v. Mathis (In re Clipper International Corp.)*, 154 F.3d 565, 567 (6th Cir. 1998):

> In reviewing district court decisions on bankruptcy matters, this court accords discretion only to "the original bankruptcy court findings, not those included in the decision rendered by the district court, since 'this court is "in as good a position to review the bankruptcy court's decision as is the district court."'" *In re Omegas Group, Inc.*, 16 F.3d 1443, 1447 (6th Cir. 1994) (citations omitted). The court reviews bankruptcy court findings of fact for clear error and conclusions of law *de novo*. *Id.*

In the present case, not only do the trustee and Household disagree on the interest rate that may appropriately

be charged to the debtors for retention of the collateral at issue, they even disagree on the appropriate standard of review to be utilized by this court in evaluating the bankruptcy judge's determination. The trustee argues that the court's ruling involves only a factual determination as to which of several competing rates most closely approximates market value. As a result, she contends that the ruling of the bankruptcy court should be reviewed only under the clear error standard normally reserved for such factual determinations. *See, e.g., Roach v. United States*, 106 F.3d 720, 723 (6th Cir. 1997) (citing *Anderson v. City of Bessemer*, 470 U.S. 564, 573, 84 L. Ed. 2d 518, 105 S. Ct. 1504 (1985)). Household submits, however, that the issue before the court actually requires selection of the appropriate methodology to be used in making a market rate calculation, and thus entails legal conclusions that are to be reviewed by this court *de novo*. *See id.*

Although, at its basic level, the bankruptcy court decision in this case turns upon a finding that one of a variety of potential interest rates should be considered to reflect true "market value," Household is correct that the court is first called upon to establish for the circuit the *methodology* under which that rate is to be calculated. Consequently, the selection of the appropriate interest rate does indeed involve a legal determination that must be reviewed *de novo* without a presumption of correctness. *See Gen. Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 66 (3d Cir. 1993).

II. "Cram Down" under Chapter 13

Although the Bankruptcy Code nowhere uses the words "cram down," the term has come to denote the confirmation of

a plan over the objection of a secured creditor. Pursuant to the provisions of 11 U.S.C. § 1325(a)(5)(B), a bankruptcy court may approve a plan proposed by a Chapter 13 debtor without the consent of the affected creditor if:

(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim.

In *Memphis Bank & Trust Co.*, 692 F.2d at 429, we recognized that the law, in effect, "requires the creditor to make a new loan in the amount of the value of the collateral rather than repossess it, and the creditor is entitled to interest on his loan." (Footnote omitted.) Such interest payments are mandated simply "in order for the secured creditor to get payments over time under the plan having a present value equal to the allowed amount, as the above quoted statutory language directs." *Gen. Motors Acceptance Corp.*, 999 F.2d at 66.

In reference to determination of the appropriate rate of interest to be added to Chapter 13 payments, we declined to "tie the interest rate to an arbitrary . . . rate," and instead held that:

> In the absence of special circumstances bankruptcy courts should use the current market rate of interest used for similar loans in the region. Bankruptcy courts are generally familiar with the current conventional rates on

> various types of consumer loans. And where parties dispute the question, proof can easily be adduced.

Memphis Bank & Trust, 692 F.2d at 431. Even after such a seemingly clear explanation by this court of the proper method for calculating interest in cram down situations, Household now cites additional Sixth Circuit decisions in an attempt to justify its effort to maximize debtor payments to itself to the detriment of other creditors.

For example, the finance company discusses in its brief on appeal the holding in *Cardinal Federal Savings & Loan Ass'n v. Colegrove (In re Colegrove)*, 771 F.2d 119 (6th Cir. 1985). In *Colegrove*, a case arising "in the context of home mortgage arrearages," keith m. lundin, chapter 13 bankruptcy § 112.1, at 112-2 (3d ed. 2000), the court concluded:

> The most equitable rate to establish in this type of situation is the prevailing market rate of interest on similar types of secured loans at the time of allowance of the creditors[']claim and the confirmation of the plan in bankruptcy with a *maximum limitation* on such rate to be the underlying contract rate of interest.

Colegrove, 771 F.2d at 123 (emphasis in original). Household focuses upon that language to support its position that the appropriate interest rates for the automobile transaction in this case should also be determined by reference to "the underlying contract rate of interest." We have, however, limited *Colegrove* to its particular facts -- a home mortgage

arrearage situation in which the creditor "was completely secured and was not required to accept unsecured status as to any portion of its debt." *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989). Because the factual situation in this appeal in no way resembles the facts of *Colegrove*, we conclude that the decision in that case is inapplicable here.

Household also cites the *Arnold* decision in support of its argument that *Memphis Bank & Trust*'s references to "the current market rate of interest used for similar loans in the region" and "the current conventional rates on various types of consumer loans" actually relate only to a lender's own interest rate and not an actual "market" or "conventional" rate. In *Arnold*, we resolved a dispute involving a Chapter 12, rather than a Chapter 13, bankruptcy, but we noted that Chapter 12's cram down provision "is identical to that found in Chapter 13." *Arnold*, 878 F.2d at 927. Then, in determining which of competing interest rates to apply, we held "that where a 'cramdown' occurs . . . and a creditor is forced to write-down a portion of its note, a creditor is entitled to receive *its* current market rate on the 'new loan.'" *Id.* at 930 (footnote omitted) (emphasis added). Household contends that this court's use of the word "its" in describing the relevant market rate indicates that a more general rate need not be considered and that the interest rate at which the particular creditor would loan money to the particular debtor may be used for cram down purposes.

There is, however, absolutely no indication in *Arnold* or in other Sixth Circuit decisions that use of the phrase "its market rate" mandates assessment in this case of interest at the rate at which a loan would be made by Household to borrowers identical to the Kidds in all relevant respects. In

fact, adoption of such a rate is tantamount to endorsement of the automatic application of a contract rate of interest, a principle clearly at odds with the clear language of *Memphis Bank & Trust*. Rather, it is more likely that use by the panel in *Arnold* of the modifier "its" to describe the appropriate market rate was intended solely to limit consideration to rates relevant to the particular *types of loans* at issue. For instance, the setting of the market rate for automobile loans should be limited to consideration of only the automobile loan universe and not rates that would apply to an average borrower seeking, for instance, financing for a new home.

Furthermore, as noted by the bankruptcy court in *In re Richards*, 243 B.R. 15, 22 (Bankr. N.D. Ohio 1999), the purpose of Chapter 13's cram down provisions is to ensure "that a secured creditor . . . receives payment equal to the vlue of the collateral as of the effective date of the plan." To the extent that the debtor's payments are spread out over time, "the creditor will actually receive less than what he is entitled to due to the simple fact that a sum of money received over [time] does not have the same value as a sum of money received today." *Id.* Hence, in *Memphis Bank & Trust*, we concluded "that current market rates of interest would best approximate the present value of a secured claim." *Id.* Thus, payment of that amount and that amount alone satisfies the purposes of the cram down provisions. In fact, "to permit a secured creditor to receive interest on his claim in an amount greater than the conventional market rates would allow the creditor to actually receive more than the allowed amount of his secured claim." *Id.*

Finally, an analysis of the language used in *Memphis Bank & Trust* clearly negates application of an interest rate

that can be determined only on a case-by-case basis through analysis of information provided and controlled by the creditor. Clearly, the opinion does not anticipate imposition of a rate of interest that would apply in the non-existent "market" that encompasses the factors prevalent in the bankruptcy setting. Rather, by stating that "bankruptcy courts are generally familiar with the current *conventional rates* on various types of consumer loans," *Memphis Bank & Trust*, 692 F.2d at 431 (emphasis added), we directed the use of more generally applicable rates. Moreover, had loan-specific rates been contemplated in formulating the proper interest calculus, there would have been no need to refer to "conventional rates." Indeed, adoption of the position espoused by Household in this appeal would virtually ensure that bankruptcy courts would *not* be familiar with the rates charged by various lenders to different borrowers based upon varied elements of a personal credit history. Rather than conclude that the *Memphis Bank & Trust* court inserted wholly superfluous language into its opinion, we elect to give effect to the carefully chosen terms used in the decision.[1]

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[1] Similarly, had the *Memphis Bank & Trust* court desired to mandate use of an interest rate that would approximate the rate for which the lender would contract, it could easily have used the term "contract rate" in delineating the analysis to be undertaken. Or, as some courts have done, it could have created a presumption in favor of the contract rate as the coerced loan rate. *See, e.g., General Motors Acceptance Corp.*, 999 F.2d at 67-68.

III. Analysis of Bankruptcy Court's Factual Determination of Appropriate Rate

Having reviewed *de novo*, and concurred in, the bankruptcy court's decision to examine "conventional" interest rates in setting the appropriate present value of Household's secured claim, we must now apply the more deferential clear error standard in determining whether the bankruptcy judge's selection of a 10.3% interest rate was proper.

At the evidentiary hearing conducted by the bankruptcy court, testimony was offered that even Household, an admitted sub-prime lender with much higher interest rates than could otherwise be obtained, offered loans at rates as low as 10.95%. Even more germane to the bankruptcy court's final determination, however, was the testimony of a local bank officer who surmised that the weighted average of *all* conventional car loans in the area was 9.3%. Finally, evidence was adduced that only occasionally were objections filed to plans calling for 8% interest rates on automobile loans, "ten and ten and a half don't draw that many objections[,] eleven rarely does and twelve almost never." In light of such information, and considering the fact that no objection was voiced to the finding that interest rates in the relevant vicinity had recently risen, the bankruptcy judge was not *clearly* erroneous in setting a 10.3% interest rate as a "current conventional rate" on consumer automobile loans.[2]

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[2] The creditor also contends that the bankruptcy court, in settling upon an acceptable interest rate, erroneously considered similar rates to which Household had agreed in other Chapter 13 bankruptcies in the months prior to the Kidds' filing. As stated by

CONCLUSION

The principles of valuation espoused in the case of *Memphis Bank & Trust Co. v. Whitman* constitute the law of the circuit and are entitled to precedential deference. In order to give effect not only to the plain wording of that decision, but also to the underlying rationale for the ruling and for the applicable provisions of the Bankruptcy Code, we conclude that the proper interest rate to be applied in a Chapter 13 cram down is the current conventional market rate used for similar loans in the region, and not necessarily the contract rate. Such a determination does not entail an analysis of any particular debtor's credit rating but rather involves a more objective determination of the value of money over time so as to compensate a creditor according to the present value of its secured claim.

Moreover, we conclude that the bankruptcy court did not clearly err in arriving at the 10.3% interest rate figure applied to Household's claim. We therefore AFFIRM the judgment of the district court sustaining the decision of the bankruptcy court.

CONCUR and DISSENT

SIMPSON, District Judge, concurring in part, and dissenting in part. I respectfully dissent from the majority

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the district court in its review of the bankruptcy court ruling, however, this allegation of error need not be addressed on appeal because the other testimony offered at the evidentiary hearing and summarized above was sufficient to support the bankruptcy court's factual determination.

opinion to the extent that it interprets Memphis Bank & Trust Co. v. Whitman[1] to require reference to "more generally applicable"[2] or "conventional"[3] rates of interest which are unrelated to the particular debtor, when determining the appropriate rate of interest for coerced loans in cram-down situations.

Section 1325(a)(5)(B)(ii) states that a plan shall be confirmed if "the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim." If the secured claim is to be paid over time, the bankruptcy court must assess interest so that the value of the claim is not diluted through delay in payment. The secured creditor is forced to extend a new collateralized loan to the debtor, hence the "coerced" loan concept.[4] *Memphis Bank* mandates that the bankruptcy court determine and apply the current market interest rate for similar loans in the region, not some other unrelated arbitrary rate.[5]

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[1] 692 F.2d 427 (6th Cir. 1982).

[2] Majority Opinion (Maj. Op.), pg. 11.

[3] Maj. Op., pgs. 11-12.

[4] *See, Memphis Bank*, 692 F.2d at 429 ("In effect the law requires the creditor to make a new loan in the amount of the value of the collateral rather than repossess it, and the creditor is entitled to interest on his loan.")

[5] 692 F.2d at 431.

I believe that the application of a generalized rate of interest, in this instance that of the pool of all prime automobile loans, is both arbitrary and a departure from the clear directive of *Memphis Bank*.

The coerced loan is not made in a vacuum, but rather to an actual debtor/borrower, with a discernable degree of predictable risk both as to default and collection/transaction costs. Because such coerced loans are generally without an "equity cushion," the potential for loss to the creditor/lender is even greater. Since *Memphis Bank* requires that what happens in a cram down be viewed as a coerced loan, the bankruptcy court ought to analyze the kind of loan being made so that interest rates on similar loans can be determined. This, in turn, requires consideration of the amount and duration of the loan, as well as the nature of the collateral and the characteristics of the debtor/borrower.

Such an inquiry is faithful to *Memphis Bank* and likely to put the secured creditor in a position very close to what it would have been in had it been allowed to repossess its collateral. The result is that the coerced loan is not made on unrealistic terms either from the creditor's or the debtor's viewpoint. More importantly, the valuation requirements of 11 U.S.C. § 1325(a)(5)(B) are respected because neither party has the possibility of an advantage due to the arbitrary imposition of some generalized interest rate.

Because the loan marketplace will take into account prevailing interest rates and risk factors, the bankruptcy court need only determine what market interest rate would be charged, at the time, on such a loan to such a borrower. The contract, if not too old, may provide evidence of how the

market would price such a loan.

Memphis Bank does not require a loan rate available from the particular creditor to the debtor. Rather, the bankruptcy court ought to determine a market rate bearing some real-world relationship to the coerced loan in issue. Here, the "conventional" rate of interest of 9.3% as determined by the bankruptcy court was based upon an average of all prime automobile loans in the region, for new and used vehicles. But this average did not include the sub-prime loan market in which the original loan had been obtained.[6] There was no showing that the debtors had transformed into prime borrowers. Thus the rate applied was, in fact, an unrelated arbitrary rate. The bankruptcy court's addition of 1% to the 9.3% to account for "special circumstances" described as "recent increases in the prime rate of interest"[7] is arbitrariness on top of arbitrariness.

The majority finds refuge for this result in *Memphis Bank's* observation that "bankruptcy courts are generally familiar with the current conventional rates on various types of consumer loans."[8] The majority converts this dictum into a mandate that only current conventional interest rates can be used for coerced cram-down loans in bankruptcy.

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[6] Joint Appendix, pp. 258, 262-63, 266.

[7] August 14, 2000 Findings of Fact and Conclusions of Law, pg. 3.

[8] 692 F.2d at 431.

While such uniformity is a bit more convenient, it is at odds with reality. The time value of money is not in all cases the same. The fact that the lending market reflects a multitude of interest rates at any one moment is a clear demonstration that the market factors the element of risk into the time value of money. Were it not so, rates for all borrowers would be the same for a given time period, and the availability of credit would be commensurately constrained.

Risk entails many factors. Among them are the likelihood of repayment as revealed by the financial profile of the borrowers, the nature of the collateral, the size of the equity cushion, and the transaction costs attendant to collection of principal and interest.

The generally higher rates of interest charged to sub-prime borrowers account for factors which reduce the odds that the debtor will recover the value of the collateral over time.[9] *Memphis Bank* recognizes that the purpose in assessing interest on the secured portion of the claim is to protect the value of the claim from dilution. To achieve this goal, the element of risk must be factored in more precisely than by simplistically utilizing average interest rates only available to

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[9] *See, In re Glueck*, 223 B.R. 514, 522 (Bankr. S.D. Ohio 1998) ("[A] 'forced loan' of 100 of the value of an automobile is not customary in the industry, and produces additional risks to lenders.") *See also, In re Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990) (listing numerous factors which are utilized by lenders in establishing interest rates).

prime borrowers.[10]

Because the majority approves the imposition of cram-down loan interest rates based on prevailing generalized conventional loan rates, rather than loans similar in quality to the coerced loan itself, I must respectfully dissent.

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[10] Other courts considering the issue raised here have also employed a particularized approach which incorporates market-based factors including, *inter alia*, risk, in determining the appropriate cram-down interest rate. *In re Till*, 301 F.3d 583 (7th Cir. 2002); *In re Smithwick*, 121 F.3d 211 (5th Cir. 1997); *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63 (3d Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993); *In re Hardzog*, 901 F.2d 858 (10th Cir. 1990); *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989); *In re Glueck*, 223 B.R. 514 (Bankr.S.D.Ohio 1998); *In re Cassell*, 119 B.R. 89 (Bankr.W.D.Va. 1990).

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In the Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTION PRESENTED

What is the rate of interest a secured creditor is entitled to receive during the life of a Chapter 13 bankruptcy plan?

CORPORATE DISCLOSURE STATEMENT

Respondent, SCS Credit Corp., in compliance with Supreme Court Rule 29.6, states that it has no corporate affiliations.

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STATEMENT OF THE CASE

SCS Credit Corp., respondent, accepts petitioners' Statement of the Case, except SCS Credit Corp. never argued that it was, per se, entitled to its contract rate of interest. Petitioners' Petition for Writ of Certiorari at p. 3. Instead, SCS Credit Corp. stated that it was entitled to its current rate of interest for loans similar to the one previously made to the debtors. The current interest rate of 21% happens to equal the contract interest rate.

SUMMARY OF ARGUMENT

The respondent, SCS Credit Corp., prefers that this Court reject petitioners' Petition for Writ of Certiorari. First, the Seventh Circuit decision of *In re Till*, 301 F.3d 583 (7th Cir. 2002) is a correct interpretation of 11 U.S.C. §1325(a)(5)(B)(ii). Second, SCS Credit Corp. does business only in the Seventh Circuit territory. Since SCS Credit Corp. prevailed in the Seventh Circuit, it has nothing to gain if this Court grants the Petition. In fact, if this Court grants the Petition, then SCS Credit Corp. will have to expend considerable resources to litigate this matter further. Nevertheless, since there is a conflict among the circuits on how to interpret 11 U.S.C. §1325 (a)(5)(B)(ii) and since the issue involved is of substantial importance, this Court should grant the Petition if it has the time to address the issue.

ARGUMENT

In a Chapter 13 bankruptcy proceeding, 11 U.S.C. §1325(a)(5)(B)(ii) requires the debtor to propose a plan which will provide the secured creditor with payments over the term of the plan that will equal the present value of the allowed secured claim. Failure of the plan to comply with this present value requirement gives the secured creditor grounds to object to confirmation of the plan. *Matter of Smithwick*, 121 F.3d

211, 213 (5th Cir. 1997). In Chapter 11 and Chapter 12 bankruptcy proceedings, 11 U.S.C. §1129(b)(2)(A)(i)(II) and 11 U.S.C. §1225(a)(5)(B)(ii), respectively, contain the concept of present value. Courts interpreting these virtually identical statutes requiring present value routinely agree that the concept has the same meaning regardless of whether a debtor is in Chapter 11, Chapter 12, or Chapter 13. *In re Corley*, 83 B.R. 848, 851 (Bankr. S.D. Ga. 1988); *Matter of Southern States Motor Inns, Inc.*, 709 F.2d 647, 652 n.6 (11th Cir. 1983). In *U.S. v. Arnold*, 878 F.2d 925, 928 (6th Cir. 1989) the court said "[a]s §1225(a)(5)(B) and §1325(a)(5)(B) are identical, we hold that the provisions should be similarly construed."

Ten circuits of the United States Courts of Appeals have reviewed the concept of present value in a bankruptcy plan. All ten circuits have held that present value means the secured creditor is entitled to a "market rate" of interest. *In re Valenti*, 105 F.3d 55, 64 (2nd Cir. 1997); *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 66 (3rd Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d 1126, 1130 (4th Cir. 1993); *Matter of Smithwick*, 121 F.3d 211, 214 (5th Cir. 1997); *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427, 431 (6th Cir. 1982); *Koopmans v. Farm Credit Serv. of Mid-America, ACA*, 102 F.3d 874, 875 (7th Cir. 1996); *In re Fisher*, 930 F.2d 1361, 1364 (8th Cir. 1991); *In re Fowler*, 903 F.2d 694, 697 (9th Cir. 1990); *In re Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990); *Matter of Southern States Motor Inns, Inc.*, 709 F.2d 647, 652-53 (11th Cir. 1983).

Although all of the aforementioned circuit courts have held that a secured creditor is entitled to the market rate of interest in order to receive the present value of its claim, there is disagreement about the method to use to determine the market rate of interest. The 2nd Circuit held that the market rate of interest under 11 U.S.C. §1325(a)(5)(B)(ii) is the

United States Treasury Bill rate (T-Bill) plus an additional risk premium of 1 to 3 interest points. This is the formula approach. *In re Valenti*, 105 F.3d at 64. *In re Fowler*, the leading 9th Circuit decision, has also adopted the formula approach, but it did not place an artificial cap on the number of interest points to be added to the base rate of interest. Instead, the *Fowler* court, citing 5 Collier On Bankruptcy §1225.03[4][c], at 1225-23, said "that the use of a formula should be only a presumption, and that courts should always allow the parties to introduce evidence of market rates to rebut the presumption." *In re Fowler* 903 F.2d 694, 698 (9th Cir. 1990).

The other eight circuits which have addressed the concept of present value and how to determine the market rate of interest have either explicitly or implicitly adopted the "coerced loan" approach. *General Motors Acceptance Corp. v. Jones*, 999 F.2d at 68 (3rd Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d at 1130 (4th Cir. 1993); *Matter of Smithwick*, 121 F.3d at 214 (5th Cir. 1997); *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d at 429 (6th Cir. 1982); *United States v. Arnold*, 878 F.2d at 928 (6th Cir. 1989); *Koopmans v. Farm Credit Serv. of Mid-America, ACA*, 102 F.3d at 875 (7th Cir. 1996); *In re Fisher*, 930 F.2d at 1364 (8th Cir. 1991); *In re Hardzog*, 901 F.2d at 860 (10th Cir. 1990); *Matter of Southern States Motor Inns, Inc.*, 709 F.2d at 652 n.7 (11th Cir. 1983). Courts which have adopted the coerced loan approach view a bankruptcy reorganization plan as effectively coercing the creditor to extend a new loan to the debtor. According to the 3rd Circuit, because creditors are forced to extend a loan to the debtor for the duration of the bankruptcy plan, the creditor is entitled to the interest rate it would charge at the time of the effective date of the plan for a loan of similar character and duration. *General Motors Acceptance Corp. v. Jones*, 999 F.2d at 70. The 7th Circuit

adopted the coerced loan approach in *Koopmans v. Farm Credit Serv. of Mid-America, ACA,* 102 F.3d 874 (7th Cir. 1996). The *Koopmans* court had to decide what interest rate would give a secured creditor its present value in a reorganization plan. The *Koopmans* court said "we now hold that the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." *Koopmans* 102 F.3d at 875. The *Till* opinion reaffirms the *Koopmans* holding that the interest rate must be the rate the creditor would obtain at the time of confirmation for a loan of similar duration and risk. *In re Till*, 301 F.3d at 592. In order to promote judicial economy, the *Till* court also adopted a procedural rule called "the rebuttable presumption rule." *In re Till,* 301 F.3d 592-93. This rule, which the 3rd and 5th circuits have also adopted, simply says that there is a presumption that the contract rate of interest that the debtor voluntarily agreed to pay is the creditor's current interest rate for the type of loan previously made to the debtor. Either the creditor or debtor may present evidence that the creditor currently receives either a higher or lower interest rate for similar loans. *In re Till,* 301 F.3d 592-93. *General Motors Acceptance Corp. v. Jones,* 999 F.2d 63, 70-71 (3rd Cir. 1993), *Matter of Smithwick,* 121 F.3d 211, 214-15 (5th Cir. 1997). Contrary to the assertions of the petitioners, the decision of *In re Till* 301 F.3d 583 is a correct interpretation of 11 U.S.C. §1325. If the Petition for Writ of Certiorari is granted, SCS Credit Corp. will make a more elaborate explanation of its position and its opposition to the petitioners' interpretation of 11 U.S.C. §1325.

Although the decision of *In re Till* is correct, undoubtedly there is disagreement among the circuit courts as to the proper method to determine the market rate of interest in a Chapter 13 plan. In fact, there is now a split of authority on this issue

in the 6th Circuit. In *U.S. v. Arnold*, 878 F.2d 925, 930 (6th Cir. 1989), the court ruled "we hold that where a 'cram-down' occurs under §1325(a)(5)(B) and a creditor is forced to write down a portion of its note, a creditor is entitled to receive its current market rate on the 'new loan'" (emphasis added). The *Arnold* court was clearly focusing on the interest rate a secured creditor would currently charge for a loan similar to the loan previously made to the debtor. However, the recent 6th Circuit decision of *In re Kidd*, 315 F.3d 671, 678 (6th Cir. 2003) held that the interest rate could be determined by looking at conventional market rates of interest even though the creditor was an unconventional or non-prime lender. Judge Simpson dissented, arguing that conventional market rates of interest were not relevant since the debtor could not qualify for such a loan. 315 F.3d at 679. The *Kidd* decision is obviously in conflict with prior 6th Circuit decisions and the Seventh Circuit decision of *Till*.

The interest rate paid on a secured claim in a Chapter 13 plan is clearly of substantial importance to debtors and creditors alike. If the interest rate is not determined correctly, one of the parties will suffer financially. Only this Court knows if the issue is of enough importance to justify the use of some of its limited resources to resolve the conflict among the circuit courts.

CONCLUSION

The Seventh Circuit *Till* decision is correct. If the Court has the time to resolve the issue on a nationwide basis, it should do so. If the Court does not have the time, then justice in this case will have prevailed. Creditors and debtors in the Seventh Circuit and the majority of other circuits will earn and pay, respectively, the proper rate of interest in Chapter 13 plans.

Respectfully submitted,

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No. 02-1016

AUG 11 2003

IN THE

Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

On Writ of Certiorari
To The United States Court of Appeals
For The Seventh Circuit

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED JANUARY 2, 2003
CERTIORARI GRANTED JUNE 16, 2003

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The following opinions, orders, decisions, judgments, relevant statutes, orders, and amended chapter 13 plan have been omitted in printing this Joint Appendix because they appear on the following pages in the Appendix to the Petition for Writ of Certiorari:

1. Court of Appeals Order Denying Petition for Rehearing entered October 10, 2002 .....Pet. App. 1a
2. Court of Appeals Opinion entered August 21, 2002 .....Pet. App. 3a
3. District Court Order entered November 1, 2000 .....Pet. App. 34a
4. Bankruptcy Court Order Confirming Amended Plan entered June 27, 2000 .....Pet. App. 40a

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UNITED STATES DISTRICT COURT
SEVENTH CIRCUIT COURT OF APPEALS

No. 00-4167

LEE M. TILL, *et al.*,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
12/7/00	Bankruptcy case docketed. [00-4167] [1352405-1] Transcript information sheet due 12/18/00. Appellant's brief due 1/16/01 for Lee M. Till, for Amy M. Till (kell)
12/14/00	ORDER: Appellant Lee M. Till, Appellant Amy M. Till shall file a brief memorandum stating why this appeal should not be dismissed for lack of jurisdiction. [1352405-1] DW [00-4167] [1354786-1] Briefing is SUSPENDED pending further court order. (See order for further details) Jurisdictional memorandum due 1/2/01 for Amy M. Till, for Lee M. Till. (land)
12/27/00	Filed Appellants Lee M.Till and Amy M. Till jurisdictional memorandum. [00-4167] [1357491-1] (jame)
11/27/01	ORDER re: Jurisdictional memorandum filed by appellants and the response filed by the appellee. This appeal shall proceed to briefing. The brief

DATE	PROCEEDINGS
	ing schedule is as follows: [1357491-1] DW [00-4167] Appellants' joint brief due 1/2/02 for Lee M. Till, for Amy M. Till, Appellee's brief due 2/1/02 for SCS Credit Corp. Appellants' joint reply brief due 2/15/02 for Lee M. till, for Amy M. Till. Further, the clerk is directed to distribute, along with the briefs in this appeal, copies of this order, the court's order of December 14, 2000, the appellants' "JURISDICITONAL MEMORANDUM" filed on December 27, 2000, and appellee's response filed on January 16, 2001. (land)
4/10/02	Case heard and taken under advisement by panel: Circuit Judge Kenneth F. Ripple, Circuit Judge Daniel A. Manion, Circuit Judge Ilana D. Rovner. [00-4167] [1497192-1] (broo)
8/21/02	Filed opinion of the court by Judge Rippie. The judgment of the district court is VACATED and the case is REMANDED with instructions. The parties shall bear their own costs of this appeal. Circuit Judge Kenneth F. Ripple, Circuit Judge Daniel A. Manion, Circuit Judge Ilana D. Rovner, dissenting. [00-4167] [1352405-1] (land)
9/3/02	Filed 30c Petition for Rehearing and Petition for Rehearing Enbanc by Appellant Amy M. Till, Appellant Lee M. Till. Dist. [00-4167] [1542884-1] (hard)
10/10/02	ORDER: Appellant Amy M. till, Appellant Lee M. Till Petition for Rehearing and Petition for Rehearing Enbanc is DENIED. [00-4167] [1542884-1] (kell)

UNITED STATES DISTRICT COURT
SOUTHERN INDIANA

Court of Appeals Docket No. 00-4167

LEE M. TILL, *et al.*,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

RELEVANT DOCKET ENTRIES

DATE	NO.	PROCEEDINGS
07/06/00	1	Bankruptcy N/A from BK Court Cause No. 99-13425-FJO-13, Record is nOT complete. eod 07/07/00 [DLD]
07/07/00	2	NOTICE to the parties that the appeal has been filed with the USDC. Cm CLERK eod 07/07/00 {DLD]
09/20/00	8	BRIEF cs APPELLANT'S BRIEF eod 09/21/00 {DLD]
10/02/00	9	BRIEF cs APPELLEES BRIEF eod 10/03/00 {DLD]
11/02/00	12	CLOSED Remanded to the United States Bankruptcy Court. (See Order) cm LJM eod 11/02/00 [DLD]
11/22/00	14	NOTICE OF APPEAL from District Court Order entered 11/01/00, remanding case to U.S. Bankruptcy Court. c/s Debtors/ Appellees (Lee & Amy Till). Eod 11/29/00 [GRN]

DATE	NO.	PROCEEDINGS
12/05/00	22	JOINT MOTION for Stay of Enforcement of District Court's Order Remanding Case . . . Pending Appeal c/s (Parties) eod 12/06/00 [GRN]
12/07/00	23	ORDER GRANTS MOTION of Parties for Stay of Enforcement of District Court's Order Remanding Case for further Consideration of Appropriate Interest Rate on Deferred Value Factor c/m LJM eod 12/07/00 [GRN]
10/21/02	27	MANDATE RECEIVED FROM CA. The judgment of the District Court is VACATED and the case is REMANDED to the District Court with instructions that the judgment of the Bankruptcy Court be vacated and that further proceedings consistent with this opinion be held in the bankruptcy court, all in accordance with the decision of the C/A entered 10/21/02. Received certified copy of opinion and judgment. Records returned consisting of 1 vol pleadings & 4 vols loose pleading. eod 10.21.02 [GRN]
12/02/02	28	CLOSED Remanded to U.S. Bankruptcy Court for the Southern District of Indiana for further proceedings consistent with the opinion of the Seventh Circuit Court of Appeals. Acting pursuant to direction from the Seventh Circuit Court of Appeals, this Court now orders that the judgment of the Bankruptcy Court is VACATED cm LJM eod 12/04/02 {DLD]

UNITED STATES BANKRUPTCY COURT
SOUTHERN INDIANA

Docket No. 00-4167

LEE M. TILL, *et al.*,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

RELEVANT DOCKET ENTRIES

DATE	NO.	PROCEEDINGS
10/25/1999	5	CHAPTER 13 PLAN FILED [Entered: 10/27/1999] [XX]
11/24/1999	16	OBJECTION TO THE CONFIRMATION OF THE PLAN, FILED BY SCS CREDIT CORP. [Re: #35] [Entered: 11/24/1999 [XX]
12/02/1999	17	RESPONSE FILED BY DEBTORS TO OBJECTION TO CONFIRMATION BY SCS CREDIT CORP [Re: #16] [Entered: 12/03/1999][HH]
01/19/2000	22	CHAPTER 13 PLAN FILED (AMENDED) [Re: #5] [Entered: 01/20/2000] [HH]
01/31/2000	29	OBJECTION TO THE PLAN, FILED BY SCS CREDIT CORP. [Re: #22] [Entered: 02/01/2000 [XX]

DATE	NO.	PROCEEDINGS
02/07/2000	31	BRIEF (SUPPLEMENTAL) IN RE SPONSE TO SCS CREDIT CORP'S OBJECTION TO CONFIRMATION, FILED BY THE DEBTORS. [Re: #29] [Entered: 02/08/2000] [XX]
02/29/2000	33	PRO MEMO RE: CONTINUED HEARINGS ON (1) TRUSTE'S MOTION TO DISMISS; (2) OBJECTION TO CONFIRMATION FILED BY SCS CREDIT CAN DEBTORS' RESPONSE FILED THERETO. DISPOSITION: (1) WITHDRAWN. (2) BRIEF DUE W/IN 10 DAYS FROM SCS CREDIT CORP. COURT TO RULE. [Re: #31] [Entered: 02/29/2000 [XX]
03/08/2000	35	MEMORANDUM IN SUPPORT OF OBJECTION TO CONFIRMATION FILED BY SCS CREDIT CORP. [Re: #29] [Entered: 03/09/2000] [MJ]
03/29/2000	36	RESPONSE OF DEBTORS TO SCS CREDIT CORPORATION MEMORANDUM IN SUPPORT OF OBJECTION TO CONFIRMATION OF PLAN [Re: #35] [Entered: 03/30/2000] [LY]
04/17/2000	37	TRUSTEE FILED COMMENTS REGARDING THE INTEREST RATE AND AUTOMOBILE LENDER IS ENTITLED TO RECEIVE IN CHAPTER 13 PROCEEDINGS. [Entered: 04/18/2000] [XX]
06/27/2000	40	ORDER CONFIRMING CHAPTER 13 PLAN (AMENDED PLAN) [Re: #22] [Copies: 1] [Entered: 06/28/2000] [LY]

DATE	NO.	PROCEEDINGS
06/06/2000	41	NOTICE OF APPEAL FILED BY SCS CREDIT CORP. [Re: #40] [Entered: 07/06/2000 [MJ]
07/06/2000	43	TRANSMITTAL OF NOTICE OF APPEAL AND RELATED DOCUMENTS TO DISTRICT COURT; CASE ASSIGNED TO DISTRICT COURT JUDGE MCKINNEY AND MAGISTRATE SHIELDS; (CASE NO. 00-1102C) [Re: 341] [Copies: 3] [Entered: 07-02-2000]
11/02/2000	57	ORDER OF UNITED STATES DISTRICT COURT JUDGE LARRY J MCKINNEY REVERSING BANKRUPTCY COURT JUDGE'S ORDER CONFIRMING THE CHAPTER 13 PLAN [Re: 340] [Entered: 11/03/2000] [XX]
11/28/2000	60	STIPULATION ON STAY OF ENFORCEMENT OF DISTRICT COURT'S ORDER REMANDING CASE FOR FURTHER CONSIDERATION OF APPROPRIATE INTEREST RATE ON DEFERRED VALUE FACTOR FILED BY DEBTOR AND SCS CREDIT CORPORATION [Re: #57] [Entered: 11/28/2000] [MJ]
11/15/2002	77	STIPULATION ON ENTRY OF DISCHARGE WITH BANKRUPTCY CASE TO REMAIN OPEN PENDING THE DECISION OF THE UNITED STATES SUPREME COURT IF THE COURT ACCEPTS TRANSFER UNDER A WRIT OF CERTIORARI AND HEARS THIS

DATE	NO.	PROCEEDINGS
		MATTER FILED BY DEBTORS AND CREDITOR SCS CREDIT CORP. [Entered: 11/15/2002] [WU]
11/27/2002	78	ORDER ON PARTIES STIPULATION ON ENTRY OF DISCHARGE WITH THE BANKRUPTCY CASE TO REMAIN OPEN PENDING THE DECISION OF THE U.S. SUPREME COURT IF THE COURT ACCEPTS TRANSFER UNDER A WRIT OF CERTIORARI AND HEARS THIS MATTER [Re: 377] [Copies: 1] [Entered: 11/27/2002] [PA]
02/21/2003	86	DISCHARGE OF DEBTOR & CERTIFICATE OF SERVICE [Copies: 47] [Entered: 02/24/2003 1:01 AM] [Auto]

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

[Filed 1999 Oct 25 PM 4:03]

CASE NO 99-13425
FJ013

IN RE: Lee Madison Till
312-78-7180

Amy Helen Till
313-98-1051
Debtor(s)

CHAPTER 13 PLAN

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE OF SAID COURT:

COME NOW. Lee Madison Till and Amy Helen Till, Debtors herein, and propose the following plan under Chapter 13 of the Bankruptcy Code:

1. The debts of DEBTOR(S) duly proved and allowed shall be paid to the holder thereof in accordance with the provisions of Chapter 13 of the Bankruptcy Code and this Plan.

2. The future earnings of Debtor(s) are submitted to the supervision and control of this Court, and Debtor(s) shall pay to the Trustee a sum of $1,089.00 per month by

voluntary weekly wage assignment from Debtor's pay beginning within 30 days of the filing date of this case and thereafter for a full term (duration) of this plan. This plan shall be for 36 months.

3. From the payments received, the TRUSTEE will make disbursements in the following order:

(a). Administrative Expenses: The TRUSTEE shall FIRST pay the expenses as prescribed by the Court, for administering of this plan.

Name of Creditor	Type	Amount	Interest Rate	Monthly Payment	Term	Total Paid
Trustee	normal expenses					

(b). Priority Claims: All Claims entitled to priority under Section 507 of the Bankruptcy Code will be paid as follows:

Name of Creditor	Claim Amount	Amount Entitled To Priority	Interest Rate	Monthly Payment	Term	Total Paid
Internal Revenue Service	$2,582.00	$2,582.00	0%	Pro-Rate	1-17	$2,582.00

(c). Secured Claims: Secured creditors, whose claims are duly and timely filed, approved and allowed will be treated as follows:

(1). Valuation of Collateral: The Creditors listed below have a claim secured by a lien on the collateral shown and the claim of each such creditor is secured to the extent of the fair market value of such property. The value of such creditor's interest in such collateral is as set forth hereinbelow and such fair market value set hereinbelow is binding as to each such creditor. Pursuant to the Bankruptcy Code, the Debtor(s) ask the Court to value the

collateral shown as indicated below and to determine what portion, if any, of the following claim or claims are secured and what portions are unsecured. The purpose of this plan provision and valuation is to clearly provide that once Debtor(s) have paid such fair market value through the TRUSTEE, the lien of each such secured creditor shall be deemed invalid and, at such time, each creditor shall immediately execute and deliver any and all necessary documents to effectuate release of such lien and delivery of an unencumbered title to the Debtor(s).

Name of Creditor	Collateral Description	Fair Market Value
Ace Financial	1996 Dodge Stratus	$8,500.00
Heilig-Meyers Furniture Co.	kitchen table	$50.00
Radio Shack Credit Card Plan	scanner & speakers	$75.00
SCS Credit Corporation	1991 S-10 Truck	$4,225.00

* *Variable payments are scheduled, please see Pro Forma, if attached.*

Computer software provided by LegalPRO Systems, Inc., San Antonio, Texas (210) 820-3001.

Each secured creditor described herein shall retain the lien existing prior to the commencement of the case only to the extent of the value of the collateral and to secure payment of the allowed amount of its claim. In the case of each secured creditor listed in this section, the allowed amount is the fair market value set forth herein. Once the allowed secured amount has been satisfied through the Plan, the creditors lien will have been satisfied in full and the lien will no longer exist. Upon payment of the secured portion of a creditor's claim, the creditor shall immediately release its lien and deliver clear title to the Debtor(s).

(2). Payment of Secured Claims: Secured creditors, whose claims are duly and timely filed, approved and allowed, will be paid as follows:

Name of Creditor	Amt. Claimed Value of Collat.	Principal Amt to Be Paid	Interest Rate	Monthly Payment	Term	Total Paid
Ace Financial	$11,000.00 Value:$8,500.00	$8,500.00	9.5%	Pro-Rata	1-17	$9,089.31
Heilig-Meyers Furniture Co.	$525.00 Value: $50.00	$50.00	0%	Pro-Rata	1-17	$50.00
Radio Shack Credit Card Plan	$750.00 Value: $75.00	$75.00	0%	Pro-Rata	1-17	$75.00
SCS Credit Corporation	$4,500.00 Value: $4,225.00	$4,225.00	9.5%	Pro-Rata	1-17	$4,517.89

(3). Void Lien: The secured creditors listed below hold a non-purchase money, non-possessory security interest on Debtor(s) exempt property. Their lien will be voided pursuant to 11 U.S.C. § 522(f) and their claim treated as unsecured and paid pursuant to paragraph (c) below:

Name of Creditor	Collateral Description	Amount of Claim
Heilig-Meyers Furniture Co.	HHS	$1,300.00

(d). Special Class: The following specially classified claims shall be paid as follows: None

Name of Creditor	Claim Amount	Principal Amt. To Be Paid	Interest Rate	Monthly Payment	Term	Total Paid

(e). Unsecured Claims: Unsecured claims will be paid by the TRUSTEE after payment of the aforementioned categories, to creditors who have duly and timely filed and proved their claim, with the same having been allowed by the Court, with such

payments or dividends to be paid in lieu of the debt and in satisfaction of the debts of such creditors.

(f). No interest, penalty or additional charge shall be allowed on any account subsequent to the filing of the petition herein, except that interest shall be allowed on claims to fully secured creditors in accordance with the 11 U.S.C. § 506(b).

4. DEBTOR(S) shall pay direct the following debts outside the Plan: None

Name of Creditor	Collateral Description	Monthly Amount	Balance

5. The following secured claims are not dealt with in the DEBTOR'S plan, therefore, upon confirmation of the DEBTOR(S)' Chapter 13 Plan, the automatic stay provisions of 11 U.S.C. § 362 will be terminated and annulled with respect to each of the following claims: None

Name of Creditor	Collateral Description	Claim	Value	Deficiency

The automatic stay provisions of 11 U.S.C. Sec. 362 remain in effect as to DEBTOR(S).

The remaining portion of the debt (deficiency), if any, shall be treated as any other general unsecured claim under this plan.

6. All executory contracts of the DEBTOR(S) will be assumed unless specifically rejected herein. The following executory contracts and/or leases are ASSUMED or REJECTED as indicated below:

Name of Creditor	Contract is Assumed/Rejected
Bradford Run Apartments	Rejected
DMA Enterprise	Assumed
Maple Crest Apartments	Rejected

• *Variable payments are scheduled, please see Pro Forma, if attached.*

Computer software provided by LegalPRO Systems, Inc., San Antonio, Texas (210) 820-3001.

7. Upon confirmation of this plan, title of the property of the estate shall vest in DEBTOR(S).

8. The Court may, from time to time, during the period of the plan, extend, increase or reduce the amount of any of the installments provided for by the plan, or extend or shorten the time for any such payments where it shall be made to appear, after such hearing, upon such notice as the Court may designate, that the circumstances of DEBTOR(S) so warrant or so require; provided, however, that nothing in this plan shall be construed to prevent the granting of a discharge of DEBTOR(S) as provided in 11 U.S.C. § 1328.

Additional Provisions of the Plan

Tax Refund

Debtors shall remit one half (1/2) of their Federal Tax refund over the cushion amount of $500.00 for the 1999, 2000, and 2001 tax years.

DATED on this the 21 day of October, 1999.

/s/ Lee Madison Till
DEBTOR: LEE MADISON TILL

/s/ Amy H. Till
Debtor: AMY HELEN TILL

UAW-Daimler Chrysler Legal Services Plan

/s/ Edward M. Kohan
Edward M. Kohan
Bar Number: 20967-49
217 Southway Blvd. East
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Fax: (765) 864-6424

PROOF OF CLAIM

[Filed 1999 Nov 15]

UNITED STATES BANKRUPTCY COURT:
SOUTHERN DISTRICT OF INDIANA

Name of Debtor: Lee and Amy Till

Case Number: 99-13425

NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A "request" for payment of an administrative expense may be filed pursuant to 11 U.S.C. § 503.

Name of Creditor (The person or other entity to whom the debtor owes money or property): *SCS Credit Corp*

□ Check box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars.

□ Check box if you have never received any notices from the bankruptcy court in this case.

□ Check box if the address differs from the address on the envelope sent to you by the court.

Name of address where notices should be sent: SCS Credit Corp., 620 S. Ironwood Dr., Mishawaka, IN 46544, Telephone number: 800-455-3371

Account or other number by which creditor identifies debtor: 32518

□ Check here if this claim □ replaces □ amends a previously filed claim dated: _____

1. Basis for Claim

■ Goods sold

□ Services performed

□ Money loaned

□ Personal injury/wrongful death

□ Taxes

□ Other _____

□ Retiree benefits as defined in 11 U.S.C. § 1114(a)

□ Wages, salaries, and compensation (fill out below)

Your SS #:____ ____ ____

Unpaid compensation for services performed from (date)_____ to (date)_____

2. Date debt was incurred: 10-02-98

3. If court judgment, date obtained:

4. Total Amount of Claim at Time Case Filed: *$4,894.89*

If all or part of your claim is secured or entitled to priority, also complete Item 5 or 6 below

□ Check this box if claim includes interest or other charges in addition to the principal amount of the claim. Attach itemized statement of all interest or additional charges.

5. Secured Claim.

■ Check this box if your claim is secured by collateral (including a right of setoff).

Brief Description of Collateral:

□ Real Estate

□ Motor Vehicle

□ Other

Value of Collateral: *$4,000.00*

Amount of arrearage and other charges at time case filed included in secured claim, if any: *$994.03*

6. Unsecured Priority Claim.

□ Check this box if you have an unsecured priority claim

Amount entitled to priority $____

Specify the priority of the claim:

□ Wages, salaries, or commissions (up to $4,300) * earned within 90 days before filing of the bankruptcy petition of the debtor's business, whichever is earlier—11 U.S.C. § 507(a)(3).

□ Contributions to an employee benefit plan—11 U.S.C. § 507(a)(4).

□ Up to $1,950* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use—11 U.S.C. § 507(a)(6).

□ Alimony, maintenance, or support owed to a spouse, former spouse, or child—11 U.S.C. § 507(a)(7)

□ Taxes or penalties owed to governmental units—11 U.S.C. § 507(a)(8).

□ Other—Specify applicable paragraph of 11 U.S.C. § 507(a)(__).

* Amounts are subject to adjustment on 4/1/98 and every three years thereafter with respect to cases commenced on or after the date of adjustment.

7. Credits: The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim.

8. Supporting Documents: Attach copies of supporting documents, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, court judgments, mortgages, security agreements, and evidence of perfection of lien. DO NOT SEND ORIGINAL DOCUMENTS. If the documents are not available, explain. If the documents are voluminous, attach a summary.

9. Date-Stamped Copy: To receive an acknowledgment of the filing of your claim, enclose a stamped, self-addressed envelope and copy of this proof of claim.

Date: ____

Sign and print name and title, if any, of the creditor or other person authorized to file this claim (attach copy of power of attorney, if any):

/s/ Kimberly, Desits,
KIMBERLY, DESITS, Recovery Specialist

Penalty for presenting fraudulent claim: Fine of up to $500,000 or imprisonment for up to 5 years or both. 18 U.S.C. §§ 152 and 3571.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

[Filed 1999 Nov. 24]

IN RE:	)
	) - CASE NO. 99-13425
LEE MADISON TILL	) CHAPTER 13
CASE NO. 994 3425	
AMY HELEN TILL	)
Debtor.	)

OBJECTION TO CONFIRMATION OF PLAN

COMES NOW SCS Credit Corp., hereinafter referred to as Secured Party, by counsel, and in support of its objection to confirmation of the debtor's plan states as follows:

1. On or about the 25th day of October, 1999, Debtor filed a Petition for Relief under Chapter 13 of the United States Bankruptcy Code.

2. The indebtedness was and now is secured by a lien on a vehicle pursuant to a Retail Installment Contract and Security Agreement entered into by and between Secured Party and the Debtor. A copy of said Retail Installment Contract and Security Agreement is attached hereto as Exhibit A.

3. Debtor has submitted a Plan to this Court indicating an intent to pay Secured Party interest on its secured claim in the amount of 9.5%. Secured Party objects to the proposed rate of interest because it does not comply with the requirements of 11 U.S.C. Sec. 1325(a) because Secured Party is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk as the loan made by Secured Party to the Debtor. Secured Party is entitled to interest at the rate of 21 %, which is the rate of interest it would obtain if it could foreclose on the vehicle and reinvest the proceeds in loans of equivalent

duration and risk as the loan made to the Debtor by Secured Party. Failure of the Debtor to comply with 11 U.S.C. Sec. 1325(a) gives Secured Party grounds to object to confirmation of the Plan submitted by the Debtor to this Court.

WHEREFORE, Secured Party requests that this Court not confirm the Plan submitted by the Debtor, and that a hearing be held to determine the appropriate rate of interest which Debtor must pay to Secured Party in a proposed Chapter 13 Plan, and any and all other appropriate relief.

/s/ John M Smith #14345-20
JOHN M SMITH
Attorney for Secured Party
214 W. Marion Street
Elkhart, IN 46516
(219) 295-4537

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing motion was served on the 22 day of Nov., 1999 upon the following: Lee and Amy Till, 502 E. Spraker, Kokomo, IN 46901, Edward M. Kohan, 217 Southway Blvd. E., #106, Kokomo, IN 46902, Robert A. Brothers, 151 N. Delaware St., Suite 1940, Indianapolis, IN 46204-2526, U.S. Trustee, 101 W. Ohio St., #1000, Indianapolis, IN 46204.

/s/ John M. Smith
JOHN M. SMITH

765-453-6695

RETAIL INSTALLMENT CONTRACT AND SECURITY AGREEMENT

No 10173
Date 10/02/98

Buyer LEE TILL
AMY TILL
Address 706 MAUMEE DR
KOKOMO, IN 46902
"You" and "your" means each Buyer above and guarantor jointly and severally

Seller
Instant Auto Finance, Inc
Address 411 Flint Way
Kokomo IN 46901
"We" and "us" means the Seller above, its successors and assigns

SALE: You agree to purchase the property described below according to the following terms, including those on the reverse side.
You agree to pay us the principal sum of Six Thousand Four Hundred Twenty-Five and 75/100 dollars ($ 6,425.75 XX); plus interest from October 2, 1998 at:
Check one { (FIXED RATE) ☒ The rate of 21.00 % per year until paid in full
(VARIABLE RATE) ☐ The initial rate of N/A % per year, which rate is subject to change so as to always be N/A the following base rate N/A N/A
If "variable rate" is checked above, the interest rate in effect on this contract may change (as often as) N/A (assuming there is a change in the base rate) and an increase in the interest rate will cause an increase in N/A
You will pay the total amount due as follows (subject to change if marked "variable rate" above):
(a) XX In 62 installments of $ 117.43 each, beginning JAN 12, 19 99 and continuing on the same day of each 14 Day Period thereafter until paid in full.
(b) XX ☐ (other) 6 Payments of $167.43 Bi-Weekly Beginning OCT 20,1998
XX ☐ You agree to pay a late charge of 5% of the unpaid amount of an installment that is not paid within 10 days after it is due, up to a maximum of $ 10.00
PREPAYMENT: You may prepay this contract in full at any time.
XX ☐ You agree to pay a minimum finance charge of $ 0.00 if you pay this contract off before we have earned that much in interest.

SECURITY: You give us a purchase money security interest in the property described below, including all accessions, attachments, accessories, equipment and all proceeds from the property. **WARRANTY INFORMATION IS SUPPLIED TO YOU SEPARATELY.**

MAKE	YEAR	MODEL	BODY TYPE	LICENSE NO. YEAR	SERIAL NO
CHE	1990	S-10 EXT-	2DR	1GCCS19Z5L	2144196

Other Description

ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate	FINANCE CHARGE The dollar amount the credit will cost you.	AMOUNT FINANCED The amount of credit provided to you or on your behalf.	TOTAL OF PAYMENTS The amount you will have paid when you have made all scheduled payments.	TOTAL SALE PRICE The total cost of your purchase on credit, including your down payment of $ 300.00
21.00 %	$ 1,859.49	$ 6,425.75	$ 8,285.24	$ 8,585.24

	Number of Payments	Amount of Payments	When Payments Are Due
Your Payment Schedule will be:	6	$ 167.43	Bi-Weekly Beginning OCT 20,1998
	62	$ 117.43	Bi-Weekly Beginning JAN 12,1999
		$	

☐ **Variable Rate:** The annual percentage rate may increase during the term of this transaction if N/A
Any increase will take the form of N/A
If the rate increases by N/A % in one N/A the N/A will increase to N/A
The rate may not increase more often than once a N/A, and may not increase more than N/A % each N/A. The rate will not go above N/A %

Security: You are giving a security interest in the goods or property being purchased.
XX ☐ **Late Charge:** You will be charged 5% of the unpaid amount of an installment that is not paid within 10 days after it is due, up to a maximum of $ 10.00
Prepayment: If you pay off this contract early, you ☐ may XX ☐ will not have to pay a penalty.

You can see your contract documents for any additional information about nonpayment, default, any required repayment before the scheduled date, and prepayment refunds and penalties.
Filing fees $ N/A
e means an estimate

CREDIT INSURANCE

Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional costs.

Type	Premium	Term
Credit Life	0.00	0 Months
Credit Disability	0.00	0 Months
Joint Credit Life	0.00	0 Months

You ☐ do XX ☐ do not want credit life insurance
X
You ☐ do XX ☐ do not want credit disability insurance.
X
You ☐ do XX ☐ do not want joint credit life insurance
X
XX

PROPERTY INSURANCE

You may obtain property insurance from anyone that is acceptable to us. If you get the insurance from or through us you will pay
$ ____ for ____ of coverage.
The property insurance premium is calculated as follows:
☐ Fire-Theft and Combined Addl Coverage $ ____
☐ $ ____ Deductible Comprehensive Cov $ ____
☐ $ ____ Deductible Collision Coverage $ ____
☐ ____ $ ____

The above insurance does not include liability insurance coverage for bodily injury and property damage unless such insurance is specifically described above.

ITEMIZATION OF AMOUNT FINANCED

1. Cash Price (excluding Sales Tax)	$ ~~6,395.00~~
2. Down Payment Computation	
Description of Trade-in	
(a) Gross Trade-In Allowance	$ 0.00
(b) Pay-Off (if any)	$ 0.00
(c) Net Trade-In (a minus b)	$ 0.00
(d) Cash Down Payment	$ 300.00
(e) Total Down Payment (c plus d)	$ 300.00
3. Unpaid Balance of Cash Price (1 minus 2(e))	$ 6,095.00
4. Other Charges	
(a) To Insurance Companies	$ 0.00
(b) To Public Officials	$ 11.00
(c) Documentation Fee	$ 0.00
(d) Sales Tax	$ 319.75
5. Subtotal (3 plus 4(a) through 4(d))	$ 6,425.75
6. Prepaid Finance Charges XXXXXXXXXXXX	$ 0.00
7. Amount Financed (5 minus 6)	$ 6,425.75

NOTICE TO BUYER: (1) Do not sign this contract before you read it or if it contains any blank spaces. (2) You are entitled to an exact copy of the contract you sign. (3) Under the law you have the right, among others, to pay in advance the full amount due, and to obtain under certain conditions a partial refund of the finance charge. (4) This contract shall become effective only when signed and executed by the buyer and seller, and shall apply to and inure to the benefit of and bind the heirs, executors, administrators, successors and assigns of both parties to this contract.

BUYER ACKNOWLEDGES RECEIPT OF A COPY OF THIS RETAIL INSTALLMENT CONTRACT

1. Signed Lee Till Buyer
2. Signed Amy H Till Buyer

YOU ALSO AGREE TO THE TERMS ON THE REVERSE SIDE OF THIS CONTRACT.

Signed ____ For Seller
Title ____

ASSIGNMENT

Seller assigns this contract on 10/2 '98
to SCS CREDIT CORP.
____ in accordance with the Seller's Assignment appearing on the reverse side. The assignment is XX 1. ☐ Without Recourse 2. ☐ With Recourse 3. ☐ Subject to a Separate Agreement.
Instant Auto Finance, Inc. (Seller)
By Title

White First Copy - Original Canary Second Copy - Seller / Assignee's Copy Pink Third Copy - Buyer's Copy Goldenrod Fourth Copy - Seller's Copy

MOTOR VEHICLE

BEST AVAILABLE COPY

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

[Filed 2000 Jan. 31]

IN RE:	)	
	)	CASE NO. 99-13425
LEE MADISON TILL	)	CHAPTER 13
AMY HELEN TILL	)	
Debtor.	)	

OBJECTION TO CONFIRMATION OF PLAN

COMES NOW SCS Credit Corp., hereinafter referred to as Secured Parry, by counsel, and in support of its objection to confirmation of the debtor's plan states as follows:

1. On or about the 25th day of October, 1999, Debtor filed a Petition for Relief under Chapter 13 of the United States Bankruptcy Code.

2. The indebtedness was and now is secured by a lien on a vehicle pursuant to a Retail Installment Contract * and Security Agreement entered into by and between Secured Parry and the Debtor. A copy of said Retail Installment Contract and Security Agreement is attached hereto as Exhibit A.

3. Debtor's original Plan indicated an intent to pay Secured Party interest on its secured claim in the amount of 9.5% and Secured Party filed an Objection. On or about the 19th day of January, 2000, Debtor filed and Amended Plan which still provides for 9.5% interest and Secured Party continues to object to the proposed rate of interest.

* Duplicate copy of exhibit inserted at J.A. 21 omitted here in printing.

WHEREFORE, secured Party requests that this Court confirm the Plan submitted by the Debtor, and that a hearing be held to determine the appropriate rate of interest which Debtor must pay to Secured Party in a proposed Chapter 13 Plan, and any and all other appropriate relief.

/s/ John M. Smith
John M. Smith #14345-20
Attorney for Secured Party
214 W. Marion Street
Elkhart, IN 46516
(219) 295-4537

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above and foregoing motion was served on the 27 day of January, 2000 upon the following: Lee and Amy Till, 502 E. Spraker, Kokomo, IN 46901, Edward M. Kohan, 217 Southway Blvd. E., #106, Kokomo, IN 46902, Robert A. Brothers, 151 N. Delaware St., Suite 1940, Indianapolis, IN 46204-2526, U.S. Trustee, 101 W. Ohio St., #1000, Indianapolis, IN 46204.

/s/ John M. Smith
JOHN M. SMITH

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA

Case #99-13425-13

Indianapolis, Indiana
February 29, 2000
9:43 a.m. O'clock

IN THE MATTER OF: LEE AND AMY TILL
Debtors

TRANSCRIPT OF CONTINUED HEARINGS ON: (1) TRUSTEE'S MOTION TO DISMISS; (2) OBJECTION TO CONFIRMATION FILED BY SCS CREDIT CORP., AND DEBTOR'S RESPONSE FILED THERETO BEFORE THE HONORABLE FRANK J. OTTE, J.U.S.B.C.

APPEARANCES:

For the Debtors:	EDWARD KOHAN, ESQ. 217 Southway Boulevard Kokomo, IN 46502
For SCS Credit Corp.:	JOHN SMITH, ESQ. 214 W. Marion Street Elkhart, IN 46516
For the Chapter 13 Trustee:	ROBERT BROTHERS, ESQ. Office of Robert A. Brothers, Chapter 13 Trustee 151 N. Delaware Street, Suite 1400 Indianapolis, IN 46204
Electronic Sound Recording Operator:	Cathy Ford

Proceedings Recorded by Electronic Sound Recording
Transcript Produced by Certified Transcription Service

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[3] (On the record at Tape #1, Index # 0060, 9:43 a.m.)

THE COURT: Till. We have Amy Till. This is a Chapter 13. My appearances are Ed Kohan for the debtors, and we have Bob Brothers, our Chapter 13 Trustee, and we have John Smith for the SCS Credit Corporation. The cause number in this case is 99-14325. Good morning, everybody.

ATTORNEYS: Good morning, Your Honor.

THE COURT: Mr. Brothers, first of all—first off, we have your motion to dismiss and the response. Now we're going to get involved in a very important legal issue here, but before we get involved in it, let's see where we're headed. Have you got a case that's going to be dismissed on us, or are we going to have a case that is viable?

MR. BROTHERS: No, Judge, I don't think so. At this time we would move to withdraw our motion as to the non-payment feature.

THE COURT: All right, sir.

MR. BROTHERS: We're getting adequately paid. That almost transforms our remaining two points in our motion, the best effort test issue, into almost an objection as opposed to the motion to dismiss. There are—Mrs. Till has a new job that's not previously been reflected in the paperwork filed, and also there is a large payment going to Rent-A-Center at 346 a month. We think at the tail end of the plan, probably at least the last year, that money should be available for [4] funding, and we'd ask that it be ordered paid over to us in full.

THE COURT: Rent-A-Center. What are we—what does that represent?

MR. KOHAN: Your Honor, that's the leasing of furniture. The debtors are leasing all of their furniture, I understand, and that represents the payment to Rent-A-Center.

THE COURT: Oh, my goodness. That's not a good deal in any sense of the word. You don't have some folks that can loan you some furniture?

MR. TILL: No, sir.

MRS. TILL: No, sir.

THE COURT: All right, well, what—what is it, Mr. Brothers, that you are requesting be done here then from the standpoint of the other creditors of that, at the end of the lease arrangement with Rent-A-Center—

MR. BROTHERS: That we be paid the 346 monthly for the final year of the plan. And in addition to that, at the present time, since Mrs. Till's income has never been treated in this filing, I think the best effort test needs to be met. Her income has to be considered. It hasn't been to date.

THE COURT: Okay. Okay.

MR. BROTHERS: And it is a new job, apparently.

THE COURT: Yes, sir.

MR. KOHAN: Your Honor, at the 341 hearing Mrs. Till [5] planned on being hired as prison guard in the new prison that's being built up north. It did not pan out. We informed the Trustee that in a couple of months we looked to see if she was working. She's not currently working. She was never—I don't know—did you not make it through the boot camp?

MRS. TILL: I did not make it through the training, no.

MR. KOHAN: She didn't make it—it's very, very rigorous training. She didn't make it through, so she's not working as a prison guard. She's not currently employed.

THE COURT: And you've got two young children at home.

MRS. TILL: Yes, I do.

THE COURT: All right.

MR. BROTHERS: The only issue left then, we'd like the 346 a month for twelve months—the last twelve months of the plan life, and we go away.

MR. KOHAN: We'll agree to file the new I and J once that payment goes away. I'll be more than willing today to give you the 346, but I would like to file an entire I and J just to see where they stand. I don't know where they're going to be in two years from now.

THE COURT: That makes sense, counsel.

MR. BROTHERS: The only problem is if we'll ever see any of the 346. It's like of like a game that gets played with [6] us. There's always a way to modify the budget to say, "Our 346 vanished. We paid it for two years, but we don't have it for the last year."

THE COURT: Well—

MR. BROTHERS: We never get the money, Judge, when they want to amend their I and J. We never see a penny of it. And it's now available, and it will be available for the next two years—

THE COURT: Well, the—

MR. BROTHERS: —and there's no reason it wouldn't be available for year three.

THE COURT: But as a practical matter, the flip side of it is is that that 341 represents the furniture they have now and at the end of these two years the furniture goes back, they're going to need—they're going to need something to replace that furniture, too.

MR. BROTHERS: I presume they're purchasing it.

THE COURT: Well, I think Rent-A-Center sounds like they're renting it.

MR. TILL: It's a rent with option to buy.

THE COURT: I see.

MR. TILL: At the end of the contract we would—

THE COURT: Well, if we were dealing with certainty we probably wouldn't have to be here to begin with, but we're not dealing with certainly, and we're dealing with people who [7] are having difficulty and attempting to work it out in a way that's fair and balanced for everybody.

Let's take a look at it after two years and see where they stand.

MR. BROTHERS: Yes, Your Honor.

THE COURT: I understand what you're saying, Mr. Brothers. That's the reality of a lot of promises we get here, but we'll take a look at it afresh and see where we stand.

MR. BROTHERS: Okay, thank you, Judge.

MR. KOHAN: Thank you, Judge.

THE COURT: All right. Now one final note on that before we continue here. These debtors will be furnishing the Trustee copies of their 1040s throughout the life of the plan. I'm certain of that, correct, Mr. Brothers?

MR. BROTHERS: It's not part of the plan offered, but we'd—we'll be willing to do that.

THE COURT: I would like to make that a part of the plan. And before we launch into the problem that we're all here for today—and that is the—what will be the interest rate that will be paid to SCS, I do note that this is one case with similar cases following, and I see counsel in the back here—Theresa Dearing and Dave Walton—have similar cases of this type, and I don't know what I'm going to do yet on this. I'm going to hear from everybody on it, but what I would like to do is to set their cases aside until we can finally get [8] this decided and get it clarified, and if they want to stay here they can, but they're free to leave if you want to also. I'm going to try to get some order to this so everybody knows where we are on this, and the debtors and the creditors don't have to keep coming in and battling this issue. So you're, of course, free to stay.

Now we have—Mr. Brothers, I want to hear from you on this issue, sir. You're aware of it. Tell me, what's the Trustee's position?

MR. BROTHERS: Well, the Trustee's position over the twenty-one years I've served in this capacity has been kind of one of, I guess, marked simplicity. At the beginning of my trusteeship in the late Seventies, after the Act was codified, I got together with some of the car lender creditors and some of the more prominent filers for debtors, and we discussed what seemed to be a fair percentage. We all agreed at that time that ten per cent was acceptable to both the debtor and the creditor community, at least as far as that microcosm of

people went, and that's kind of what we've tracked all—lo' these many years, Judge. Occasionally a debtor will drop below that to a, say, 8 per cent on an offer, but by and large that's been kind of a standard feature. I know that that approach would, from an appellate standpoint, would cut absolutely zero mustard in terms of—because it isn't a system. It was a number simply pulled out of the air.

[9] In terms of what's out there now and the approaches being used in the appellate court system, I'm impressed mostly by the—what appears to be a standard that possibly a majority of the courts are adopting, and that's the prime-plus standard that Judge Bayt used in his *Carson*, decision—decision back in 1998, and I think Judge Metz subsequently followed it, and that's simply computing the prime interest rate as of petition date—not as of confirmation date, but a nice, easy, out-front date, easy for all to compute—date of petition. When you're ready to file it you compute the prime and then add what historically these cases are treating as a one to three per cent additional risk factor in order to give the creditors some buffer against possible loss.

In this case, in *Carson* Judge Bayt pegged it at prime plus one and a half and adopted that as his future standard for all automobile interest rates that would come before him, and I think Judge Metz has followed that. That has added simplicity in our ability to run our office, and it's something that is readily computable and I think works quite effectively.

The courts have noted that you don't really have to reward the creditor with a higher interest rate over and above what it would have to pay to borrow money, and I know the creditor before the Court today is seeking what I perceive to be kind of its standard lending rate or market rate of 21 per cent, but this is just one creditor with this rate. Many of [10] our other lenders are substantially lower, so there appears to be little certainty when a debtor or debtor's counsel would attempt to prepare a petition as to what one would have to offer. Do you

have to come up with a 21 per cent for this creditor, or can you go down the road—?

For instance, the other day I noticed Hubler Dodge, down at 3800 South East Street or South Madison, their market rate was absolutely zero finance charge, and they were doing that as part of a promotion, but that was their rate. So their—in essence, with them you can walk into their dealership, compute the price of a brand new vehicle, divide it by 36 or 48 or 60 months, and that's your payment.

Without a standard other than market rate—or with the market rate standard that I think the creditor seeks and I'd ask this Court to adopt, you're always going to be playing with something slipping and sliding around that the average counsel wouldn't be able to compute it. The prime plus is easily ascertainable on a daily basis, and it wouldn't work in a way to engage this Court in sort of a, what I think is a frustrating search for what might be non-existent markets or non-existent similar loans that you would be dealing with.

The parties all look to the *Koopman's* case, Judge—it's the Seventh Circuit Chapter 12 case that came down some time ago to treat the interest factor that would be allowable. I really, probably for the first time—I'd read *Koopman's* [11] before but never gave it a hard read. I did it this morning, and I'm—it's kind of amazing when you go through the ruling. They adopt the prime plus standard, yet within the same sentence state that the lender is entitled to its market rate of interest. You can't have it both ways. You simply can't. I think there must have been some confusion at that level.

At the close-out of *Koopman's*, though, I think one of the final lines that the Court, the Seventh Circuit level, said,

> "You simply have to read the cost of capital from newspaper tables, based upon actual transactions in competitive markets."

Well, I did that today. I pulled the newspaper and I looked at it, and the table I saw is prime. It's the only thing I could go

by other than T-bill rates, which are lower, and I think probably no one has. Prime, as of today, for instance, is 8.75 per cent interest.

Now if you track the—if you track the Judge Bayt decision in *Carson* you'd add one and a half points to that and you'd have a ten and a quarter loan, easily computable when you sit down and meet with the debtor and put together a plan and yet gives the creditors some hedge factor on its risk. I think it's a good idea, and I think it's an appropriate standard to adopt.

The auto lender further has other built-in [12] protections available to it. It can come to the meeting, file a motion for relief from stay if it isn't adequately being protected in terms of being paid at a reasonable rate per month, or if it is not giving us lien retention which the Code mandates it can get relief that way. If the insurance is not in place, it can get relief that way. It also has the ability to scrutinize the I and the J the debtor files, in terms of whether this is a feasible offer. It could perfect its interest in that regard. It can come in and demand a wage assignment if it sees a debtor with a regular job.

I want a buffer against loss. I don't want this plan to belly up and I sit here—six, eight, nine months go by—I get a trickle of payments and the plan fails. Get a wage—it can argue for a wage assignment being in place and therefore work to protect its interest in that regard.

So the creditor has early-on tools available to it in terms of being able to come to a meeting and get quick relief if the offer is inappropriate. But I would urge the Court to adopt the prime-plus standard across the board as far as all the loans in this division are concerned.

THE COURT: Thank you, sir.

MR. BROTHERS: Sure.

THE COURT: Now, Mr. Smith, I want to hear from you. This is your motion. This is a motion that was filed in objection to the confirmation of the plan because the plan [13] offers a five point—or a 9.5 per cent—per cent rate. Yes, sir.

MR. SMITH: Thank you, Your Honor. I would agree with the Trustee that the *Koopman's*, case is the central case controlling this issue. I would disagree respectfully with his interpretation of that decision.

The *Koopman's*, case is a little bit confusing because it's not a very long opinion. They have a short holding in there, and then they talk about the cost of funds theoretically, how, in the open market, that it'll all—you know, you can look—there are several ways you can go about figuring out the market rate of interest, but one thing the case was clear about was that you should look to how the real market terms the rate of interest, and I think there is specific language in that case that says that you should not look to the speculation of Judges, Trustees, or lawyers with respect to what the rate of interest is for a particular market.

Now in the *Koopman's*, case, that particular—the Bankruptcy Court Judge, Judge Dees, found that prime-plus was the appropriate market rate of interest for that particular loan. Expert witnesses came in and testified—this was a real estate loan. Real estate loans are usually made on the basis of a prime rate, then adding some sort of risk factor if the—if the debtors are not prime—prime candidates or [14] prime customers. But in this particular case for this particular market, that is not how the market rate of interest is determined.

This is a sub-market of the auto-lending market, and in this sub-market it is commonly referred to as non-prime or sub-prime lending, and the market rate of interest for that particular market for these type of debtors with their credit history and credit record, is 21 per cent interest, which is the

maximum rate of interest which is currently allowed under Indiana law. I can almost quote verbatim the holding in the *Koopman's* case. It says,

> "We now hold that the creditor is entitled to the rate of interest that it could obtain if it were to foreclose on the collateral and it were to reinvest the proceeds in equivalent loans of duration and risk."

By that language I think it's pretty obvious that the emphasis is on the rate of interest that the particular creditor can obtain in its market, and I just feel that that's quite clear.

I can understand the Trustee's wanting to establish some type of certainty and have an easy mechanism for computing the interest rate, but that certainly can't be done at the expense of a particular creditor if a creditor is entitled to a higher rate. I think that we can have quite a bit of certainty by adopting this standard, and this standard was actually [15] adopted, I believe by the Fifth Circuit and possibly by the Third Circuit, and what those Courts said was that you look at the current rate of—or what you do is you start with a rebuttable presumption that the rate of interest charged to that particular debtor is the current market rate of interest for that creditor. There then arises a rebuttable presumption to that effect, but the debtor can come forward, and if the debtor can present evidence that that particular creditor is now receiving either less or more—obviously the debtor is not going to argue in favor of a higher interest rate—but either side, the creditor could come in and say, "Hey, when we loaned this money out a year and a half ago, our current rate of interest for this type of loan was 15 per cent. The current rate of interest for this type of loan now is 19 per cent." Vice-versa, the debtor could come in and say, "Current rate of interest was X, it's now lower." But I think that particular method of starting with the contract rate—which is, after all, the rate of

interest that the debtors agreed to pay, usually quite recently, and that is the rate of interest that the debtors were able to obtain in the open market.

I think common sense tell us that if the debtors were able to get an eight per cent or a ten per cent loan, a prime plus one or a prime plus two loan, they wouldn't have come to this particular creditor and voluntarily paid 21 per cent interest. So I just believe that there is an efficient way to [16] carry out the holding of the *Koopman's* case and to have some certainty for debtors and creditors, and that's basically my client's position, Your Honor.

THE COURT: All right, sir. Well said. Mr. Kohan.

MR. KORAN: We agree with the Trustee's analysis of the situation, but we would also like to add, we kind of have to see what's going on here, and what SCS is trying to do effectively is get around the cramdown, and they want twenty-one per cent, they want the contract rate.

I think we have to take a look at the Code in the whole. I mean, not only 1325 which says the creditor should get the present value of their claim. I believe we've agreed that your claim is $4,225. That's the present value of their claim.

We also need to take a look at 1322. We can modify a secured creditor's rights. The only secured creditor whose rights we can't modify are those loans that are secured by real estate in the debtor's principal residence. Well, this isn't that situation. This loan is secured by a car. That's it. We can modify their rights. In *Koopman's*, they say that we should look to the market rate of interest. We are. We're looking for the market rate of interest of auto loans.

I think where I disagree with Mr. Smith is that he's looking to his sub-market of high-interest, non-prime lenders. I would argue that the creditor's characteristics are [17] irrelevant. You look to the debtor's characteristics. We're adding one

and a half per cent for risk. These creditors in the bankruptcy, they have a wage assignment to the Trustee that is working. Their plan will not be confirmed unless the Court proves that it can make all the payments in the plan, and I think they have proven this. They're paying the Trustee.

I also think you have to look at the creditors are going to lose eventually. I mean, we cannot—they're only getting—they're not getting the entire claim. We're cramming it down. I think that also allows us to cram down the interest rate to nine and a half per cent. This compensates the creditor for the present value.

I would think, and I would argue that if the debtors could come up with that $4,225 at once, we wouldn't give them any interest rate. That's their claim, but they're not. They're deferring the payments over a period of three years. Since they are deferring the payments, we have to compensate the creditor for that. We have to give them something that allows for the changing value of the dollar. I've read in a couple of the cases that the whole concept of present value and adding a discount rate kind of revolves around the proposition that a dollar today is worth more than a dollar tomorrow, a dollar a month from now, and a dollar a year from now.

THE COURT: Which automobile is SCS on?

MR. TILL: The S-10.

[18] MR. KORAN. The S-10.

THE COURT: The S-10.

MR. KORAN: Yes.

THE COURT: Not the—not the Dodge.

MR. KORAN: No.

THE COURT: All right, continue. As I reviewed this file, I needed that information. It's not in the plan. It doesn't refer to the automobile. Go ahead.

MR. KORAN: So based on that proposition that we do have to add an interest rate to compensate for the changing value of the dollar, since this $4,225 is worth more today than it will when SCS finally receives it, we have to add an interest rate, and we acknowledge that, and we are. But that doesn't mean there should be a 21 per cent interest rate that adds substantial profit and other transaction costs that just aren't here. Collection costs are eliminated. Marketing is eliminated. And as the Trustee stated before, if they don't like it they could file an objection. They still have their collateral until their claim is paid off. They're not losing any rights, and if the case is dismissed, they retain all their rights back.

We feel that nine and a half per cent is more than adequate to compensate the creditor for the present value. In computating this interest rate we used the method in *IN RE: Carson*. We looked at the interest rate at the time of filing [19] which is approximately eight per cent. We added one and a half per cent for risk, and that's where we got the nine and a half per cent for interest, and we feel that more than compensates the creditor for their claim.

THE COURT: All right, sir. Lawyers, I have a—I have a brief that has been filed in this matter by Mr. Kohan. Mr. Smith, I am aware of the fact that you filed a brief in an earlier case that we had that was then dismissed when we thought this issue would get resolved. Would you like the opportunity to file a brief in this case?

MR. SMITH: Yes, Your Honor. That—

THE COURT: How much time would you need, sir?

MR. SMITH: Probably—I could have—I should be able to have it within ten days, I would think.

THE COURT: All right. That would be fine. If there's something—if there's something in that brief that has happened somewhere in the Seventh Circuit or in one of the

other Circuits of a very unusual nature on this point, Mr. Kohan, and you want to respond to—you just give us a call and bring that to our attention, and we'll give you time to do it. Now if it's not you ve already had you already have your brief on file. Only if something has happened right on point recently—

MR. SMITH: Sure. And, Your Honor, if I could add, it may be—I'm sure everyone wants to speed this up and get [20] this issue resolved. I don't know. I'm not a big trial lawyer. I don't know how appropriate this is, but the brief that I submitted in that other case would be basically the brief that I would submit in this case, so I don't know if you as a Judge can take judicial notice of that brief and review that and thereby speed this process up if no one has any objections.

MR. KOHAN or MR. BROTHERS: I wouldn't object to that.

THE COURT: Well, I—

UNIDENTIFIED FEMALE: It wouldn't be a part of the record (unclear)

THE COURT: Yeah, it wouldn't be part of the record.

MR. SMITH: Okay. That's what I wondered. Like I said, I'm not a trial lawyer so I don't know the technicalities, but I will try to get that brief submitted as quickly as possible. I probably could do it—

THE COURT: I think it would be cleaner if we did that.

MR. SMITH: Okay.

THE COURT: now—all right, now having dealt with that aspect of this case, I have another aspect of it that I touched on earlier and we've got to address, and that is that everybody wants an answer on this, and I anticipate this case going up, but that means that we're going to have a brief [21] period of

time or some period of time while it goes through the appellate process. We have this case, the Till case, and we have these other cases where counsel has remained in the courtroom.

I would like to do this: When I make my decision on this matter, that while it will not be final because of the appellate process, I would like it to be an interim final issue so that the Trustee can get payments of all of these cases that have this issue and make distributions so we do not have a backlog of funds with the Trustee and creditors sitting out there waiting. for this issue to be decided.

Gentlemen, do you have a problem with that?

MR. SMITH: No, Your Honor. If I understand correctly, I would—my client would still file its objections, but you could move forward with the confirmation process otherwise, while we're waiting for a decision, is that correct?

THE COURT: Right. That's right. But when you say—they might not want to file an objection either.

MR. SMITH: Yeah.

THE COURT: Depending on what I do, you see.

MR. SMITH: Sure. Exactly. Right. Exactly. I understand.

THE COURT: Because there are two sides to this issue, and I'll take a hard look at it and try to come up with [22] something that gives us some order and some certainty, because one of the ways that Chapter 13s work, just to move them through very rapidly and to get a stream of payments going to creditors through our Trustee, Mr. Brothers, so that's where we are. You get your brief in in ten days, and, yes, Mr. Kohan, you're standing.

MR. KOHAN: Your Honor, I would just like to call Professor Russell. He's a Professor of Economics at IUPUI, and I think he may be able to help the Court.

THE COURT: Oh, I didn't realize that you had a—that you had a witness on this matter.

MR. KOHAN: Yes, Your Honor.

THE COURT: All right, you're here to enlighten us on this, Mr. Russell? Professor?

PROF. RUSSELL: Yes, Your Honor.

THE COURT: Come forward, sir. Let's hear what you have to say.

PROFESSOR STEVE RUSSELL, DEBTORS' WITNESS, DULY SWORN

THE COURT: All right, have a seat.

MR. BROTHERS: Judge, might I be excused in about ten minutes? I have matters down the hall.

THE COURT: Do you have any questions of the Professor?

MR. BROTHERS: No, I do not. I wanted to take in part of it, but then I do have to leave for other hearings.

[23] THE COURT: Well, you feel free when you want to, Mr. Brothers. Counsel may examine.

MR. KOHAN: Thank you.

DIRECT EXAMINATION

BY MR . KOHAN:

Q. Please state your name for the Court.
A. Steve Russell.
Q. And where are you employed?
A. I'm the Professor of Economics at IUPUI.
Q. Would you go through your employment history a little bit?

A. Yeah, I've had a—got a Ph.D. from the University of Minnesota. I taught at the University of Georgia for four years. I worked as an economist in the research department of the Federal Reserve Bank of St. Louis for three years, and I've been at IUPUI for six or seven years.

Q. What are you currently teaching?

A. The course that I teach the most frequently is Money and Banking.

Q. Okay. Thank you. Let me ask you this generally, what's the purpose of the prime rate? Why do banks and other lending institutions use that as a benchmark in computing interest rates, or starting at least off on interest rates?

A. Well, the prime rate is a rate that banks charge on loans to their most credit-worthy corporate customers, and it's part of a uniform national market, so it's a uniform rate across the [24] country. So it's easy to point out, you know, the rate on this particular class alone is going to be the same in California as in New York or anywhere else in the country, so it's a benchmark, a national benchmark rate.

Q. Okay. Does that generally take into account the change in the value of the dollar? Or maybe if you want to get into what this whole concept of the changing value of the dollar?

A. Yeah, there's three or four things in the prime rate that are also in any other market interest rate of varying degrees. There's an adjustment for the change in the purchasing power of the dollar, or the inflation rate. Right now that's probably two and a half per cent or so. There is an adjustment for the fact that something you referred to that people prefer dollars now to dollars later, and so a dollar now is a little more valuable than a dollar later, even if there is no risk that the dollar won't be repaid. And that—that number right now is probably roughly three and a half per cent. That's the difference between the inflation rate and the interest rate on a very safe loan to the federal government, a Treasury bond, okay?

So that would take us up to roughly six per cent, which was the Treasury rate on comparable loans, I think, at the time of this bankruptcy filing. The prime rate was, at the time was closer to eight per cent, and that two per cent is mostly, I think, risk to some extent transactions costs. There [25] is some risk on these loans, even though they're to pretty credit-worthy firms, because in most cases they're not secured, which makes them different from, say, a car loan.

Q. Mmhmm.

A. There's no explicit collateral on most of these loans.

Q. So generally, the loans that are secured, let's say you said car loans are—have lower interest rates than unsecured, let's just say credit card loans?

A. Right. What matters is what the lender is likely to get in the event of a default, and obviously he's likely to get much more on a secured loan than on an unsecured loan. On an unsecured loan it's possible to get nothing, and often happens.

Q. So they get some of the collateral and at least get some of their costs back.

A. Right.

Q. Okay. What, in your opinion, generally speaking, what are some of the facts—other factors that go into interest rate? You could look at prime rate, but obviously not if you want to use it as prime rate. What else is it—what else—what's the main factor that goes into—

A. Yeah, if you look at interest rates on loans, you know, that have rates above the prime interest rate, which most loans do, probably the single biggest determinant of the interest rate is the risk on the loan over and above the risk on one of these loans to a corporation that presumably is a very good [26] credit risk. There is also an adjustment for the transactions costs of making a loan, which can include things like legal costs. I could include overhead for providing the facilities to have people come in and borrow, so there is a

variety of different costs involved in making loans, and those are different, for different classes of loans, and so higher for some, lower for others.

Q. Let me ask you this: Based on what you've heard and what's been presented, would you feel that a nine and a half per cent interest rate is a reasonable interest rate for this—for an auto creditor, given the present value of their claim?

A. Yeah, I guess—I would think that nine and a half was plenty. I looked at the interest rate, the current average interest rate in the United States on new car loans. Now this is a used car loan, so you might want to add a little bit to that rate, but it was roughly eight and a half per cent, so actually interest rates on car loans are pretty low. Again, the—close to the prime rate because the security provided by the car kind of offsets the fact that these are loans to very credit-worthy firms.

Q. Mmhmm.

A. So the additional one and a half per cent, you know, in the prime plus one and a half, I guess you could interpret as an adjustment for the fact that the transactions costs of [27] making small loans to people to buy cars are higher than the costs of making big loans to General Motors or whatever. And so it seems like a very reasonable rate. So with the understanding that the risk on making the loan is fairly limited because the borrowers are under the supervision of the court and are working with a plan that's supposed to be financially feasible, et cetera, et cetera.

MR. KOHAN: Okay. Thank you very much. I'm done, Your Honor.

THE COURT: Mr. Smith, cross-examination, sir.

MR. SMITH: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. SMITH:

Q. Sir, have you ever worked for a creditor?

A. I actually have worked for a commercial bank briefly, before I went to graduate school

Q. And when was that?

A. That was when I was an undergraduate—would have been in the late 1970s, early 1980s.

Q. Okay, are you familiar with the particular credit criteria that any individual banks use in determining when to make a loan to particular customers or applicants?

A. Well, not in any degree of detail. I mean, I know the factors that are involved, but I wouldn't know how any particular creditor would assess those factors.

[28] Q. Okay. Are you familiar with the non-prime auto market, auto lending market?

A. Yeah, I know what you mean when you say "non-prime market."

Q. And how would you characterize that?

A. Again, I think it's just loans that are viewed by the lenders as sort of singularly risky or much more risky than loans that are extended at the prime rate.

Q. And do they typically have substantially higher rates, or do you know the rates that non-prime lenders typically set in this locale?

A. Yeah. I guess I wasn't familiar with the non-prime rates on auto loans. I would think that 21 per cent or something close to it might be a representative rate on an unsecured loan.

Q. But you're not—but you're not familiar—

A. But, no, I'm not actually familiar—

Q. —actually with the non-prime rates—

A. —that's correct.

Q. —for the auto market.

A. That is correct.

Q. Okay. Are you familiar with the default rates in the non prime market typically?

A. No, I'm not.

Q. And are you familiar with the costs of collection that the [29] typical non-prime lender has in collecting on these loans?

A. Again, not in any detail.

Q. Have you seen the credit report of the debtors?

A. No.

MR. SMITH: No further questions.

THE COURT: Any redirect?

MR. KOHAN: No, Your Honor.

THE COURT: Any questions, Mr. Brothers?

MR. BROTHERS: No, Judge, thank you.

THE COURT: You may step down. Thank you very much for coming. Do you have any further witnesses?

MR. KOHAN: No, Your Honor.

THE COURT: Mr. Smith, do you have any witnesses?

MR. SMITH: Yes, Your Honor. I have two witnesses and I'll try to get through those as quickly as we can. I would like to call Craig Cook to the stand, please.

THE COURT: All right.

CRAIG COOK, WITNESS FOR THE LENDER,
DULY SWORN

THE COURT: All right, please have a seat and state your name for the record.

THE WITNESS: Craig Cook.

THE COURT: Counsel may examine.

MR. SMITH: Thank you, Your Honor.

DIRECT EXAMINATION

BY MR. SMITH:

[30] Q. Mr. Cook, would you give your address, please?

A. 1242 East 90th Street, Indianapolis.

Q. And who do you work for?

A. Instant-Auto Finance.

Q. And is Instant-Auto Finance the originating credit seller in this particular transaction that we're here discussing today?

A. Yes.

Q. Instant-Auto Finance, did they sell the car on a retail installment contract basis?

A. Yes.

Q. And was that contract then subsequently assigned to a finance company?

A. Yes, it was.

Q. And which finance company was that?

A. SCS Credit Corp.

Q. Okay. And is it typical for Instant-Auto Finance to assign the retail installment contracts that it generates in the course of its business to SCS Credit Corp.?

A. Yes, it is.

Q. In fact, and they assign all those contracts to—

A. Yes.

Q. —to SCS Credit Corp.? How long have you worked for Instant-Auto Finance?

A. Thirteen years.

[31] Q. And how long have you worked here at the Indianapolis location?

A. Three years.

Q. Is that the entire time that this location has been opened and—

A. Yes.

Q. —operating?

A. Yes.

Q. What's your job title?

A. Sales manager.

Q. Do you decide whether Instant-Auto Finance will sell a vehicle to a potential customer on credit?

A. Yes, I do.

Q. What are the factors that you consider when making this credit decision?

A. Job time, time at their present address, their credit report, the amount of money that they have to put down on the vehicle.

Q. Okay. Do you ever consider references?

A. Yeah. Yeah.

Q. Okay. What is your industry referred to with respect to the type of customers to whom Instant-Auto Finance typically sells?

A. Sub-prime or non-prime.

Q. Why is it called that?

[32] A. Because the typical customers that we sell cars to have poor credit histories and are risky customers.

Q. Are you familiar with the credit history of the debtors and other relevant characteristics?

A. Yes.

Q. Is the credit history and the credit characteristics of Y the debtors similar or typical of the types of customers that Instant-Auto Finance typically sells to?

A. Yes.

Q. What was the rate of interest that Instant-Auto Finance charged the debtors when this vehicle was sold?

A. 21 per cent.

Q. What is the rate of interest typically charged by Instant Auto Finance?

A. 21 per cent.

Q. Does Instant-Auto Finance ever sell vehicles on credit other than to employees for a rate of interest of less than 21 per cent?

A. No.

Q. Based on your job experience in the industry are you aware of the interest rate charged by other similar lenders in this area?

A. Yes.

Q. And what is—what is that rate of interest?

A. 21 per cent.

[33] Q. How does Instant-Auto Finance view a credit applicant who appears to be a candidate for a Chapter 13 bankruptcy petition?

A. Negatively.

Q. Are you aware of how other lenders similar to Instant-Auto Finance view credit applicants who appears to be candidates for Chapter 13 bankruptcy?

A. Negative as well.

Q. And would your answer be the same if I were to ask you how Instant-Auto Finance or other similar lenders view applicants—credit applicants who are actually in a Chapter 13 proceeding?

A. Yes.

MR. SMITH: I have no further questions, Your Honor.

THE COURT: Cross-examination of this witness?

CROSS-EXAMINATION

BY MR. KOHAN:

Q. You decide whether or not to give credit to particular negative particular people, right?

A. Right.

Q. Do you actually decide on an interest rate? I mean I understand it's always 21 per cent. Is that something that you made the call, or does someone else make that call at 21 percent?

A. Someone else makes that call.

Q. So is it set by someone higher up in the company? Is that [34] it?

A. Yes.

Q. So you really—you don't know where they come up with that 21 per cent. It's just something they told you you charge people with bad credit.

A. I believe it's what the market will bear.

Q. Well—but I mean you don't know how they determined that 21 per cent interest, is that correct?

A. Correct.

Q. Okay. You may have heard these arguments, a lot of references to present value. Do you understand what present value means in the bankruptcy sense or the economic sense?

A. No.

MR. KOHAN: Okay. Thank you.

MR. SMITH: No further questions, Your Honor.

THE COURT: You may step down, sir. Any further witnesses?

MR. SMITH: Yes. One more, Your Honor. Neil Bird.

NEIL BIRD, LENDER'S WITNESS, DULY SWORN

THE COURT: All right, sir. Please have a seat, state your name for the record.

THE WITNESS: My name is Neil Bird.

THE COURT: Counsel may examine.

MR. SMITH: Thank you, Your Honor.

DIRECT EXAMINATION

[35] BY MR. SMITH:

Q. What's your address, Mr. Bird?

A. 1722 Bader Avenue, South Bend, Indiana.

Q. And where are you currently employed?

A. SCS Credit Corp.

Q. And how long have you been employed there?

A. Four years.

Q. And what is your job title or your position there?

A. I'm the general manager of SOS.

Q. Does that involve overseeing collections of accounts?

A. Yes, it does.

Q. Where did you work before you were employed by SOS Credit Corp.?

A. Teachers' Credit Union.

Q. How long did you work there?

A. Nine years.

Q. You've heard some of the testimony-today about prime and non-prime lending markets. How would you characterize SOS Credit Corp.?

A. We're a non-prime lender.

Q. How would you characterize Teachers' Credit Union, your employer of nine years before coming to work for SOS Credit Corp.?

A. They were a prime lender.

Q. Does SCS take assignment of retail installment contracts [36] from Instant-Auto Finance?

A. Yes, we do.

Q. And is that what happened in this particular case with the debtors—

A. Yes.

Q. —and the contract that they signed?

A. Yes, it is.

Q. Are you familiar with the credit history and the credit characteristics of the debtor?

A. Yes.

Q. Are the credit history and credit characteristics of the debtors similar to other customers that SCS Credit Corp. takes assignment of—

A. Yes, is it.

Q. —on a retail installment contract basis?

A. Yes.

Q. What is the rate of interest on the retail installment contract that SCS takes assignment of?

A. Twenty-one per cent.

Q. Is that always the case with non-employers? Are there ever any exceptions made?

A. No, there's not.

Q. And what is the rate of interest that the debtors agreed to on this particular retail installment contract?

A. Twenty-one per cent.

[37] Q. How does SCS Credit Corp. view Chapter 13 bankruptcy petitions?

A. We do not like them.

Q. Why not?

A. Because usually we don't get paid the full plan for the vehicle.

Q. Okay. Is there any delay in receiving the money?

A. Yes, there is.

Q. Do—do Chapter 13 debtors ever enter into a plan and then SCS Credit Corp. actually never receives any distributions under the plan for one reason or another?

A. Yes that's correct.

Q. Do you know how other non-prime lenders view Chapter 13 bankruptcy petitions, both with respect to potential applicants or customers that they already have on their books when a Chapter 13 petition is filed?

A. They're the same as SCS. They do not like them.

MR. SMITH: Okay. I have no further questions.

THE COURT: Cross.

CROSS-EXAMINATION

BY MR. KOHAN

Q. Do you con—do you set interest rates for SOS? Do you—

A. No, I do not.

Q. —do you control that? So again, that comes from the higher-up in the company, I take it—

[37] A. Correct.

Q. —is that correct?

A. Mmhmm.

Q. Do you know why they picked 21 per cent? It was just because that could get—that's what could get away with in Indiana?

A. That's what the market would bear.

Q. Well, that's—but that's what they could get away with also. I mean, they can't go any higher than twenty-one per cent, is—do you know? I mean,—

A. No, I do not know that.

Q. But you—again, you don't know what goes into this 21 per cent. Do you know how much is for risk? How much is for profit, how much is for marketing, how much is for collections costs?

A. No, I do not.

Q. You don't know anything that goes into this at all—

A. No.

Q. —is that correct? And again, do you understand the meaning between present value and its meaning in the bankruptcy sense and—

A. Somewhat.

Q. Really—do you have a degree in economics?

A. No, I do not.

Q. Are you an actuary?

[39] A. No.

MR. KOHAN: Okay. Well, thank you very much.

THE WITNESS: Okay.

THE COURT: Redirect?

MR. SMITH: No questions, Your Honor.

THE COURT: Thank you, sir. You may step down. Anything further, lawyers?

MR. SMITH: No, Your Honor.

MR. KOHAN: No, Your Honor.

THE COURT: All right, we have a briefing schedule that we discussed earlier—

MR. KOHAN: Yes, Your Honor.

THE COURT: —and you are aware of that. Mr. and Mrs. Till—it is Mr. and Mrs. Till?

MR. TILL: Yes, Your Honor.

MRS. TILL: Yes, Your Honor.

THE COURT: I want to—the reason I say that is I note something on your schedules where it asks marital status and it says 'Not Married," and I—

MR . KOHAN : That's—that's a typo.

THE COURT: I have your names the same and two children, so I assumed that fact. You've been with Chrysler a year.

MR. TILL: Two, Your Honor.

THE COURT: Two years now. Your schedules said one [40] year, that's why I picked that up. You have an opportunity for a very good situation if you're responsible.

MR.TILL: Yes, Your Honor.

THE COURT: On the income on your schedules your income would be over $52,000 for one year. That's just with one person in this family being employed, and that's yourself. If you're very careful with your funds you can enjoy a certain amount of freedom, and I noted throughout the schedule that you have Rapid Pay and Fast Cash and Checks to Go.

MR. TILL: Yes, Your Honor.

THE COURT: I can't think of anything worse for a young couple to do than to get involved in those organizations.

We're talking here about a 21 per cent interest rate and have a fuss over whether that's market or not. When you consider the interest rates of Check-N-Go and Fast Cash and Rapid Pay, this 21 per cent pales. You're talking about three and four hundred per cent interest on that money when you use their services. Are you aware of that?

MR. TILL: I do now, si—I mean, after I had gotten myself into that trouble, I have, Your Honor.

THE COURT: Okay. You want to be very careful. There is no—there is no dignity that is finer and no independence better than living within one's means because when you do that, you are free. When you stop and consider the fact that every loan you make you indenture yourself to that [41] creditor, you become that creditor's employee with no benefits whatsoever. And the heavier the debt, the greater the indenture. Do you understand what I'm saying?

MR. TILL: Yes, Your Honor.

THE COURT: So you're going to have an opportunity to free yourself from this as the lawyers and the system works through this issue of the interest rate; but for you personally this is a couple that has an opportunity to enjoy real freedom if you live within your means.

All right, I have the—as I said, the briefing schedule, and I'll take it from there and I'll get an answer to you gentlemen.

MR. SMITH: Your Honor, am I correct in understanding that these other cases set for today are all continued?

THE COURT: We're going to put them on hold—

MR. SMITH: Okay.

THE COURT: We're going to continue them, but we're going to—if the Trustee has no issue with it, we're going to conditionally, if you will, approve the confirmation so we get a stream of payments during this interim.

MR. SMITH: Sure. Okay. Thank you, Your Honor.

THE COURT: Any questions?

MR. KOHAN: No, Your Honor.

THE COURT: Thank you.

[42] (End at Tape #1, Index #3303. 10:31 a.m.)

* * * * *

I certify that the foregoing is a true and accurate transcript from the electronically sound recorded record of the proceedings.

/s/ Gloria C. Irwin 7/29/00
GLORIA C. IRWIN Date
Certified Transcribes NJ A0C200
Federal CET #122

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

IN RE:)
) CASE NO. 99- 1 3425-FJO-13
LEE MADISON TILL)
AMY HELEN TILL)
DEBTOR(S))

CONDITIONAL
CONFIRMATION ORDER

The debtor's plan (or amended plan) having been filed on January 19, 2000 and having been transmitted to creditors; and

The trustee, after having conducted a first meeting of creditors, has reported to the Court as follows:

1. That the plan complies with provisions of Chapter 13 and with other applicable provision of the Bankruptcy Code;

2. That the filing fee and any other amount required to be paid before confirmation has been paid;

3. That the plan has been proposed in good faith and not by any means forbidden by law;

4. That the value, as of the effective date of the plan, of the property to be distributed under the plan on account of each unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under Chapter 7 on such date;

5. That each holder of an allowed secured claim provided for the plan has accepted the plan, or the debtor has surrendered the property securing such claim to such holder; or the plan provides that the holder of each secured claim retain the lien securing said claim and the

amount to be distributed under the plan on account of such claim is not less than the allowed amount of such claim;

6. That the debtor will be able to make all payments under the plan and to comply with the plan;

7. That is the trustee or the holder of an allowed unsecured claim previously objected to the confirmation of the plan, said objection was subsequently resolved or withdrawn.

And the trustee, having reported to the Court and having recommended confirmation of debtor's plan, the Court now adopts the trustee's report and, therefore,

ORDERS, ADJUDGES AND DECREES that the debtor's plan be, and the same is hereby confirmed; and it is

FURTHER ORDERED that the trustee shall charge such percentage fee as may be periodically be fixed by the Attorney General pursuant to 26 U.S.C. §586(E) and it is

FURTHER ORDERED that the debtor shall pay Robert

A. Brothers, Trustee: 740.00 per month for 36 months ($26,640.00) starting 11-25-99. Further, and per Court order 2-29-00, the debtor shall turn over copies of tax returns, and one-half (`/z) of federal tax refunds over $500.00 starting 4-30-00. Further, and per a hearing on 2-2900, the debtors are to file an amended schedules "I" and "J" after the outside the plan payments to Rent-A-Center are paid in full (this provision to permit the trustee to monitor the ongoing Best Efforts test). And finally, SOS Credit Corporation will be paid $4,000.00 + 9.5% interest thereon, and the case is conditionally confirmed at that amount. Should the creditor be successful in an appeal of the interest factor, the debtor shall immediately modify the plan to provide additional funding for the increased interest costs.

Date: July 13, 2000

/s/ Frank J. Otte
U.S. BANKRUPTCY JUDGE

DISTRIBUTION:

Debtor; Debtor's Attorney; U.S. Trustee; Chapter 13 Trustee
John Smith, 214 West Marion street, Elkhart, IN 46516

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

CASE NO. 00-4167

LEE M. TILL, AMY M. TILL,
Debtors,

LEE M. TILL, AMY M. TILL,
Debtor-Appellants,

v.

SCS CREDIT CORPORATION,
Creditor-Appellee.

PETITION FOR REHEARING EN BANC

The Honorable Kenneth F. Ripple
The Honorable Daniel A. Manion
The Honorable Ilana Diamond Rovner
Circuit Judges

Appeal From The United States District Court
For The Southern District of Indiana, Indianapolis Division
District Court Civil No.: IP00-1102-C-M/S
The Honorable Judge Larry J. McKinney, Chief Judge

UAW-DaimlerChrysler
Legal Services Plan
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CERTIFICATE OF INTEREST

The undersigned, counsel of record for Lee M. Till & Amy M. Till, Petitioners, furnish the following list in compliance with Fed. R. App. P. 26.1 and Circuit Rule 26.1(b):

1. The full name of every party or amicus the attorney represents in this case:

   ANSWER: Lee M. Till and Amy M. Till, Petitioners

2. If such party or amicus is a corporation:

   (i) its parent corporation, if any:

   (ii) a list of stockholders which are publicly held companies owing 10% or more of the stock in the party or amicus:

   ANSWER: N/A

3. The names of all law firms whose partners or associates have appeared for the party in the case or are expected to appear for the party in this court:

   ANSWER: UAW-DaimlerChrysler Legal Services Plan
   (a/k/a UAW-GM Legal Services Plan)
   220 South Norton Avenue
   Marion, IN 46952
   Telephone: (765) 662-8411, Ext. 225

DATED: September 3, 2002 By: _____
Rebecca J. Harper
Attorney for Petitioners

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I. STATEMENT IN SUPPORT OF EN BANC REVIEW

A. Uniformity of This Court's Decisions

The majority interprets "value, as of the effective date of the plan" at 11 U.S.C. § 1325(a)(5)(B)(ii) to require that the creditor receive the "indubitable equivalent" of its non-bankruptcy entitlement (presumptive contract rate) under a "coerced loan" theory.[1]

In *Matter of Burgess Wholesale Mfg. Opticians, Inc.*, 721 F.2d 1146 (7th Cir. 1983), this Court interpreted "value, as the effective date of the plan" at 11 U.S.C. § 1129(a)(9)(C) as strictly a "time value of money" concept to require that plan payments be discounted to "present value" as of the effective date of the plan. Although the Court in *Burgess* did not define the method for determining "present value," the *Burgess* decision has been cited as Seventh Circuit precedent distinguishing the concepts of statutory "present value" and "contractual" interest.[2]

---

[1] It has been said that the "coerced loan" theory "profoundly misstates" the present value concept at § 1325(a)(5)(B)(ii). *In re Dingley*, 189 B.R. 264, 269 (Bankr. N.D.N.Y. 1995). The concept originated not in case law, but as an editor's comment in the Collier Bankruptcy treatise that "a deferred payment under a plan is like a coerced loan." 5 Collier on Bankruptcy, ¶ 1129.03, p. 1129-99, 15th ed. (1994). As described by the Court in *In re Computer Optics, Inc.*, 126 B.R. 664, 671 (Bankr. D.N.H. 1991),"without citing any . . . authority. . . , the Collier treatise took a 'quantum leap' from the present value concept (. . . time value of money) into a totally different concept of a loan transaction" involving a fact-specific inquiry that has "skewed the analysis ever since." Under the "coerced loan" theory, interest is viewed not as a "time value of money" concept, but as a creditor investment vehicle with profit as the bottom line.

[2] The Court's decision makes no attempt to distinguish the *Burgess* case, nor to reconcile its analysis with this Circuit precedent.

Because the majority's decision expands the statutory language far beyond the "present value" concept contemplated by this Court in *Burgess*—and because only the *Burgess* interpretation conforms to the statutory scheme—en banc review is required in order to secure and maintain uniformity of this Court's decisions.

B. Question of Exceptional Importance

The issue is the rate of interest to be applied under the Chapter 13 cramdown provision at 11 U.S.C. § 1325(a)(5)(B)(ii).

Adopting the "coerced loan method," the Court reasons that the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk. Slip Op. at 16-17. The Court concludes that the creditor's sub-prime contract rate—described by the dissent as an "eye-popping 21%" (Slip Op. at 19)—is presumptively correct (Slip Op. at 17).

The majority's interpretation of § 1325(a)(5)(B)(ii) places this Circuit in direct conflict with the decisions of the Second, Eighth and Ninth Circuit Courts of Appeal, all of which have adopted a "formula" method for computing the cramdown rate of interest. Slip Op. at 12. Under the "formula" method, the court adopts a risk-free market rate as a base and adds a risk premium corresponding to the court's determination of the riskiness of the reorganization plan.

The Eighth Circuit in *United States v. Doud*, 869 F. 2d 1144, 1146 (8th Cir. 1989), was the first of the Circuits to approve a bankruptcy court's use of a "formula" approach in determining Chapter 12 cramdown interest (treasury bond plus 2% risk premium). The Eighth Circuit also produced the most recent Circuit Court decision to adopt a "formula" approach in the case of *Household Auto Fin. v. Gorham*, 2001 U.S. App. LEXIS 26351, 22 Fed. Appx. 691, unpub. opin.

entered December 11, 2001 (Appendix "B") [Court approved bankruptcy court's use of treasury bond plus 2% risk premium pursuant to a local rule establishing the "Chapter 13 rate"]. The Ninth Circuit in *In re Fowler*, 903 F. 2d 694, 698 (9th Cir. 1990), concluded that the bankruptcy court had correctly adopted a "formula" approach (prime rate) for Chapter 12 cramdown, and remanded the case to the bankruptcy court for determination of an appropriate risk factor. The Second Circuit in *In re Valenti*, 105 F. 3d 55, 63 (2d Cir. 1997), ruled that Chapter 13 cramdown interest should be fixed at the treasury bond rate plus a 1-3% risk premium. The Court of Appeals in *Valenti* agreed with *Dingley*, *supra*, that "courts adopting the 'forced loan' approach misapprehend the 'present value' function of the interest rate."

The decision in the present case can be expected to have a profound impact on the jurisprudence of this Circuit. It is estimated that nearly 60% of U.S. adults have "sub prime" credit.[3] Most Chapter 13 cases are tightly budgeted, and reinstatement of the contractual interest rate will close the door to the most needy of debtors.[4]

The Chapter 13 cramdown provision at 11 U.S.C. § 1325(a)(5)(B)(ii) is first and foremost a provision permitting *modification* of the creditor's *contractual* rights. The majority decision turns the statute on its head by reinstating

[3] *See* "Sub Prime" Lending, 1998, 1999 New Media Auto Services, Inc., http://www.carinvoices.com/financing/about_financing/sub_prime_credit.htm.

[4] Payment of an allowed secured claim in an amount of $10,000.00 at 9.5% interest over the maximum five-year plan term requires base funding in an amount of $12,649.00 @ $207.00/month, whereas payment of $10,000.00 at 21% interest over the same period requires base funding of $16,356.00 @ $268.00/month—a staggering $3,707.00 increase in interest exclusive of the additional trustee fees generated thereon.

the creditor's state-law contractual rights preempted by the Bankruptcy Code.[5]

Because the statutory language at issue here appears in other sections of the Code where the statutory "time value of money" or "present value" method has been routinely employed, this decision raises imminent questions regarding the uniform application of numerous sections of the Bankruptcy Code, and can be expected to have far-reaching and unintended consequences.[6]

It is a fundamental purpose of Chapter 13 to provide debtors with an effective means of retaining property and dealing with secured creditors. H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977) *reprinted in* Vol. C, *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender 15th ed. revised). The issue in this case has divided the federal judiciary across the country—as well as the panel in this case.[7] Few other issues under the Bankruptcy Code have produced so many opinions with such confusing and varied results. Despite the controversy surrounding this issue, few could disagree that financially-stressed debtors paying 21%

[5] Remarkably, if the creditor comes forward with persuasive evidence that its current rate is in excess of the contract rate, the creditor is entitled to *interest in excess of the pre-petition contract rate* under the majority's interpretation of § 1325(a)(5)(B)(ii). Slip Op. at 17, *citing GMAC v. Jones*, 999 F.2d 63, 70-71 (3d Cir. 1993).

[6] See, e.g., 11 U.S.C. § 1325(a)(4), 11 U.S.C. § 1325(b)(1)(A), 11 U.S.C. § 1225(a)(5)(B)(ii), 11 U.S.C. § 1129(a)(7)(A)(ii), 11 U.S.C. § 1129(a)(7)(B), all of which contain the same "value, as of the effective date of the plan" language.

[7] The Court acknowledges that this "issue has caused significant disagreement among the courts of appeals, bankruptcy courts and commentators." Slip Op. at 7 (citations omitted). Because of the divergency amongst the Circuits, it has been speculated that the U.S. Supreme Court will provide a conclusion to this debate, Robert Quila, Cramdown Interest Rate: Second Circuit Court of Appeals Addresses What It Is and What It Is Not," 6 *J. Bankr. L. & Prac.* 549, 558 (1997).

interest under a Chapter 13 plan are *not* effectively dealing with their secured creditors—as the legislature intended.

ARGUMENT

Summary of Legal Error

Petitioners contend that the Court's adoption of the "coerced loan" method introduces an "indubitable equivalence" standard that has no application to Chapter 13 cramdown. The Supreme Court has rejected judicial expansion of the "indubitable equivalence" standard where not expressly mandated by statute. 11 U.S.C. § 1325(a)(5)(B)(ii) contemplates a statutory "time value of money" calculation to be accomplished by means of a "formula" approach that has no reference to the underlying contract. The decision of the Court represents an improper judicial expansion of the statute at odds with the statutory scheme.

A. "Coerced Loan" or "Indubitable Equivalence" Method Violates Statutory Scheme

In *Matter of Aberegg*, 961 F.2d 1307, 1309 (7th Cir. 1992), this Court noted that the "basic legislative purpose" underlying Chapter 13 is to provide debtors a flexible means for repaying creditors.

Pursuant to 11 U.S.C. § 1322(b)(2), Chapter 13 debtors can modify the rights of secured creditors. The Supreme Court in *Nobleman v. American Savings Bank*, 508 U.S. 324, 329, 113 S. Ct. 2106, 2110, 124 L. Ed. 2d 228, 235 (1993) determined that the "rights" implicated by § 1322(b)(2) are *those rights provided by state law*. One such right identified by *Nobleman* is the *contractual interest rate*. Nobleman establishes that a creditor's state-law property rights are recognized in bankruptcy *only* in the absence of controlling federal law. Chapter 13 "cramdown" does not by definition require creditor consent. *In re Milham*, 141 F. 3d 420, 425 (2d Cir. 1998), *cert. den.*, 525 U.S. 872, 119 S. Ct. 169, 142

L. Ed 2d 138 (1998). By attempting to arrive at the appropriate interest rate in a vacuum—without any reference to the statutory framework of the cramdown provision—the majority reaches a result completely at odds with the statute. The "very essence" of § 1325(a)(5)(B)(ii) is *contract modification*. *In re Paschen*, 296 F.3d 1203 (11th Cir. 2002). Yet courts adopting the "coerced loan" method focus on the rate of interest the *creditor* would voluntarily accept. *GMAC v. Jones*, 999 F.2d 63, 68 (3rd Cir. 1993).

The "coerced loan" theory requires adjustment of the debtor-creditor relationship so as to make the terms of the "coerced loan" as close as possible to a tenable lending decision outside a bank context and to preserve the creditor's "market" rate of interest, i.e. profit. The plain language of § 1325(a)(5)(B)(ii) conveys no such intent. *In re Dingley*, 189 B.R. 264, 269 (Bankr. N.D.N.Y. 1995). As noted by the Court in *Dingley*, the "coerced loan" theory is based upon fictional premises. It is well-settled law that the 'Bankruptcy Code protects the creditor's interest in the *property*, not . . . the creditor's interest in the *profit* it had hoped to make on the loan.' *Id.* at 269, *citing In re Hudock*, 124 B.R. 532, 534 (Bankr. N.D.Il. 1991) (emphasis added). The Supreme Court has cautioned against an interpretation of a statute "more broadly than its language and the statutory scheme reasonably permit." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578, 99 S. Ct. 2479, 2490, 61 L.Ed 2d. 82, 97 (1979), *citing SEC v. Sloan*, 436 U.S. 103, 116 (1978). Bankruptcy codifications are to be interpreted so as not to create inconsistency with other Code provisions, and "pale presumptions" are to be avoided. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242-45, 109 S. Ct. 1025, 1031-32, 103 L.Ed. 2d 290, 299-300 (1989).

This Court has previously cautioned against invocation of broad purposes of legislation at the expense of specific statutory provisions. *Central States Southeast and Southwest*

Areas Pension Funds v. Belmont Trucking Co., Inc., 788 F.2d 428, 433-34 (7th Cir. 1986). Yet the majority sees as its ultimate task "to ascertain the policy decision made by Congress in enacting the statutory provision." Slip Op. at 8. The majority starts with the premise that it is "reasonable to presume" what Congress intended, Slip Op. at 9,[8] and that:

> [T]o exclude the element of profit from the fixing of the market rate would violate the *statutory directive* that the creditor be placed in the same position as the one in which it would have been if it had been allowed to end the relationship by repossessing the collateral.

Slip Op. at 16 (emphasis added).

There clearly is no such "statutory directive," and the result reached by the Court is certainly not mandated by the language of the statute. Where Congress has sought to provide holders of secured claims with their original "contract" rate of interest or a rate that reflects current fair "market value," it has employed language substantially different from the "present value" language employed at

[8] The Court begins with the fictitious *"presumption"* that Congress intended that the three alternatives for dealing with secured claimants at 11 U.S.C. § 1325(a)(5)(A), (B) and (C)—creditor consent, surrender of collateral or cramdown—must afford the creditor "equivalent protection." Slip Op. at 9. Yet under the express language of the statute, only one of these three requirements must be met. Where the creditor has accepted the plan under § 1325(a)(5)(A), the § 1325(a)(5)(B)(ii) requirement for payment of present value need not be satisfied. *In re Szostek*, 886 F.2d 1405, 1412-13 (3rd Cir. 1989). The three options are *not* to be combined. *Matter of Williams*, 168 F. 3d 845, 847 (5th Cir. 1999). The majority's initial premise that a debtor proceeding under the cramdown provision [§ 1325(a)(5)(B)(ii)] *"must put the creditor in a position reasonably equivalent to the position it would be in ... had it received and then sold the collateral"* [§ 1325(a)(5)(C)], Slip Op. at 9 (emphasis added) leads inevitably to the conclusion that the creditor must receive the "indubitable equivalence" of its bargain in order for the debtor to retain the collateral. Slip Op. at 14-16.

§ 1325(a)(5)(B)(ii). 11 U.S.C. § 506(b) requires payment of "interest on such claim . . . provided for under the agreement" (presumptive contract rate), and 11 U.S.C. § 362(d)(3)(B) requires payments in an amount equal to "interest at a current fair market rate on the value of the creditor's interest. . . ." The contrast between these Code sections is striking. It is a fundamental premise of statutory construction that "where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello v. United States*, 464 U.S. 16, 23, 104 S. Ct. 296, 300, 78 L.Ed. 2d 17 (1983).

The Court's analysis is also completely at odds with the statutory scheme. As noted by the Supreme Court in *United Sav. Assoc. of Texas v. Timbers of Inwood Forest Assocs., LTD*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988):

> A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear . . . or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law. . . . That is the case here.

484 U.S. at 371, 108 S.Ct. at 630, 98 L.Ed.2d at 748 (citations omitted).

11 U.S.C. § 506(b) allows an oversecured creditor to add interest that accumulates prior to confirmation to the secured claimant awaiting distribution under the debtor's plan. The post-petition interest under § 506(b) becomes part of the secured claim and may accrue until the effective date of the plan. Upon confirmation, § 1325(a)(5)(B)(ii) requires that payments made under the plan return the "present value" of the § 506(b) secured claim amount to the creditor. In the case

of an oversecured creditor, § 506(b) and § 1325(a)(5)(B)(ii) compliment each other and together ensure the full payment of the value of the secured creditor's claim. *In re Harko*, 211 B.R. 116, 123 (2d Cir. BAP 1997), *aff'd*, 141 F.3d 420 (2d Cir. 1998), *cert. den.*, 525 U.S. 872, 119 S. Ct. 169, 142 L. Ed 2d 138 (1998) As a result of the reference to the "agreement under which such claim arose" at 11 U.S.C. § 506(b), the contract rate of interest is recognized as the presumptive rate of interest under § 506(b). *In re Harko*, *supra*, 211 B.R. at 119. The substitution of a contract rate of interest for "present value" interest under § 1325(a)(5)(B)(ii) ignores the different objectives underlying the selection of the interest rates under these two sections. In contrast, application of a strict "present value" approach is consistent with both the language of the statute and the clearly expressed intent of the legislative history.

In the context of Chapter 11 reorganization, both the House and the Senate recognized that "there may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the policy of bankruptcy law." S. Rep. No. 95-090, 95th Cong. 2d Sess. (1978); Report of Committee of Judiciary, H.R. 8200 No. 95-595, 95th Cong., 1st Sess. (1977). During the legislative process leading to the Bankruptcy Amendments and Federal Judgeship Act of 1984, Congress specifically considered an amendment requiring the contract rate of interest to be paid under § 1325(a)(5)(B)(ii) and rejected it. *In re Harko*, *supra*, 211 B.R. at 120, n. 7, *citing*, H.R. 1085, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 1169, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 4786, 97th Cong. § 19(2)(A) (1981). Under 11 U.S.C. § 1325(a), the court "shall" confirm the plan if certain minimal requirements for confirmation are met. A creditor thus cannot prevent confirmation by demanding greater protection than the statute affords.

The Court nevertheless concludes that the "old contract rate . . . serve[s] as a presumptive rate" under § 1325(a)(5)(B)(ii), Slip Op. at 17, thereby imposing a requirement under the statute that Congress itself rejected. It is impossible to believe that such a notable exception to the Code's overall scheme would not be unambiguously expressed, either in its text or legislative history. *Erlenbaugh v. United States*, 409 U.S. 239, 243, 34 L. Ed. 2d 446, 93 S. Ct. 477 (1972).

The Court's decision redistributes rights between debtors and creditors contrary to the statutory scheme. The majority adopts the holding of the Court in *GMAC v. Jones*, *supra*, 999 F.2d 63, wherein the Court stated as follows:

> [i]n the absence of a stipulation . . . , it would be appropriate for bankruptcy courts to accept a plan utilizing the contract rate if the creditor fails to come forward with persuasive evidence that its current rate is in excess of the contract rate. Conversely, using the same rebuttable presumption approach, if the debtor proposes a plan with a rate less that the contract rate, it would be appropriate for a *bankruptcy court to require the debtor to come forward with some evidence* that the creditor's current rate is less than the contract rate.

999 F.2d at 70-71 (emphasis added).

Under § 1325(a)(5)(A), the debtor need not satisfy § 1325(a)(5)(B) if the creditor fails to object to the plan. Requiring the debtor to "come forward with evidence" to support any below-contract interest rate renders § 1325(a)(5)(A) a nullity, and necessitates the setting of evidentiary hearings in the vast majority of Chapter 13 cases.

It is a well-recognized canon of construction that words repeated within the same statutory section have an identical meaning in the several places employed. *United States v. Nunez*, 573 F.2d 769, 771 (2d Cir. 1978), *cert denied* 436 U.S. 930, 56 L.Ed. 2d 774, 98 S. Ct. 2828 (1978). The

"value, as of the effective date of the plan" language at 11 U.S.C. § 1325(a)(5)(B)(ii) is precisely the same as language at § 1325(a)(4) and § 1325(b)(1)(A). This Court in *In re Rimgale*, 669 F. 2d 426, 430 (7th Cir. 1982) determined that § 1325(a)(4) requires payments to the creditor to be discounted to "present value." *Accord*, *In re Beguelin*, 220 B.R. 94, 99 (9th Cir. BAP 1998). In construing the same language at 11 U.S.C. § 1129 (a)(9)(C), this Court in *Matter of Burgess*, *supra*, 721 F 2d at 1147, also adopted a "present value" analysis to require that payments be adjusted "to allow for the changing value of a dollar." The Court in *In re Snider Farms*, 83 B.R. 977, 989 (Bank. N.D. Ind. 1988) construed *Burgess* as adopting the "time value of money" approach. *Accord*, *In re Martin*, 17 B.R. 924, 926 (D.N.D. Ill. 1982) [use of "present value" approach under § 1325(a)(4) is supported by weight of authority]; The Court in *In re Young*, 61 B.R. 150, 151-54 (Bankr. S.D. Ind. 1986) cited *Burgess* as Seventh Circuit precedent to distinguish statutory "present value" payments under § 1325(a)(4) and contractual interest under § 506(b). The *Burgess* narrow interpretation of the "present value" language coincides with the "formula method" proposed by Petitioners, in sharp contrast to the "coerced loan method" which focuses on the creditor's non-bankruptcy entitlement. Understandably, none of the courts adopting the "coerced loan" method make any attempt to reconcile the result with the remainder of the statute.

B. "Present Value," "Time Value of Money" and Formula Method" Inquiries Are Identical

It has been said that "present value" is not necessarily a legal concept, but rather a "term of art" used by the economic and financial communities. 1 *Blackstone's Commentaries* *59. "Present value" is the value today of a future stream of payments, discounted at the appropriate discount rate. "Present value" has been defined as the "time value of money," *In re Fisher*, 29 B.R. 542, 543 (Bankr. D. Ka. 1983),

and this definition was adopted by this Circuit in *Burgess*, *supra*, 721 F. 2d at 1147. The Court in the case of *In re Oaks Partners, LTD*, 135 B.R. 440, 445 (Bankr. N.D. Ga. 1991) noted that the "time value of money" approach is in fact *commonly referred to* as the "formula" approach.

Subsequent to many of the appellate interest-rate cases, the U.S. Supreme Court decided the case of *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 957, 117 S.Ct. 1879, 1882, 138 L.Ed.2d 148,155 (1997), which noted that, under the cramdown option, the debtor is required to provide the creditor with payments that total the "present value of the collateral."

It is said that the obligation to pay "present value" interest on a bankruptcy claim is statutory, not contractual, and that the interest rate is not controlled by contract or market.[9] Proper application of statutory "present value" thus compels application of a formula that excludes profit or other contractual elements of the pre-petition loan.

As noted by a leading commentator, "creditor-based approaches to interest rates are nightmares of logic and application." Nothing in § 1325(a)(5)(B)(ii) suggests that "value, as of effective date of the plan" is a creditor-specific inquiry. Lundin, 2 *Chapter 13 Bankruptcy* § 112.1 at 112-8 (3d ed. 2000).

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[9] The Collier comment that "a deferred payment . . . under a plan is a *coerced loan* . . ." spawned a myriad of analyses attempting to discern the "market rate" for similar loans. This is a misnomer first, because there is no market for loans of this type, and second, because these are not in fact "loans," but "claims." A "loan" includes a contractual obligation to pay interest, whereas the obligation to pay interest on a "claim" is statutory, not contractual.

C. "Coerced Loan" Method Forces Payment of "Indubitable Equivalence" Contrary to Statute

The majority focuses not on the "present value" of the creditor's claim, but instead adopts language from *Koopmans*, *supra*, 102 F. 3d at 874, 875, requiring that the creditor receive the "indubitable equivalent" of its non-bankruptcy entitlement. Slip Op. at 14-16. The sole authority cited by *Koopmans* for interjecting an "indubitable equivalence" requirement in the Chapter 12 cramdown context was the pre-Code business reorganization case of *In re Murel Holding Corp.*, 75 F. 2d 941, 942 (2d Cir. 1935). The cramdown statutes at the center of the present dispute had not even been enacted when this "indubitable equivalence" standard originated.

"Indubitable equivalence" is a "term of art" that appears only twice in the Bankruptcy Code. Providing the "indubitable equivalent" of a secured creditor's collateral is one method of giving "adequate protection" under 11 U.S.C. § 361. The expression "indubitable equivalent" is also found at § 1129 (b)(2)(A)(iii), which allows the confirmation of Chapter 11 plans over the dissent of classes of secured creditors. *See* Lundin, 2 *Chapter 13 Bankruptcy*, § 112.1 at 112-20 (3d ed. 2000) ['indubitable equivalent' is a "term of art" at cramdown in Chapter 11 cases only]; Judge Lundin discounts the precedential value of *Koopmans*, noting that the case has afforded no predictability in interest rate decisions by bankruptcy courts within the Seventh Circuit].[10]

[10] Judge Rovner's comments regarding the *Koopmans* analysis are instructive, since Judge Rovner sat on the panel that decided Koopmans. Judge Rovner points out that, although the language in *Koopmans* endorses the "coerced loan" method, this Court in *Koopmans* in fact upheld the bankruptcy court's decision to use the prime rate with enhancement. The bankruptcy court in *Koopmans* was afforded discretion denied to the bankruptcy court in the present case. Judge Rovner suggests that, to the extent that *Koopmans* can be read to require any particular approach under

In contrast, for Chapter 13 secured creditor cramdown, Congress authorized one of the other alternative provisions allowed for Chapter 11 confirmation, *not* the "indubitable equivalent" provision. As noted by the Court in *In re Metz*, 67 B.R. 462, 467 (9th Cir. BAP 1986), *aff'd*, 820 F. 2d 1495 (9th Cir. 1987), since Congress could easily have used the "indubitable equivalent" standard of Chapter 11 for the parallel Chapter 13 cramdown and chose not to do so, the "indubitable equivalent" standard cannot properly be extended to Chapter 13 confirmation.

In originating the "indubitable equivalent" concept in *Murel Holding Co.*, *supra*, 75 F. 2d at 942, the Court determined that, in order for a business reorganization plan to provide a creditor *adequate protection,* the plan must provide a substitute of "indubitable equivalence" which must *both compensate for "present value" and "insure the safety of the principal."*

It is apparent that the "indubitable equivalence" standard enunciated by *Koopmans* and adopted by the majority affords significantly greater protection to the creditor than the simple "present value" calculation at § 1325(a)(5)(B)(ii), resulting in a creditor-specific inquiry into a particular creditor's contract and lost opportunity costs.

In the Chapter 12 context, the case of *In re American Mariner Industries*, 734 F. 2d 426 (9th Cir. 1984) was widely criticized for its holding that an undersecured creditor must receive the "indubitable equivalent" of its entire bargain under § 361(3), which was construed to include the present value of the creditor's state law rights to foreclose its collateral and reinvest the proceeds. *American Mariner* was

Chapter 12, the *Koopmans* analysis was not intended to control in cases involving sub-prime consumer loans, given the dramatic difference in interest rates and the serious adverse consequences to *consumer debtors* not addressed in *Koopmans*.

overruled by the Supreme Court in *Timbers*, *supra*, 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740, where the Supreme Court held that adequate protection under § 362(d)(1) does not require post-petition payment of interest or lost opportunity costs to an undersecured creditor to compensate for the delay in a creditor's right to take immediate possession of the security and to reinvest the proceeds. The Fifth Circuit in *Timbers* noted that the "indubitable equivalent" standard sets "impossible guidelines" for adequate protection in reorganization proceedings and establishes a stringent standard inconsistent with reorganization concepts. *In re Timbers of Inwood Forest Associates, LTD*, 808 F. 2d 363, 365-68 (5th Cir. 1987). The Court noted the "disastrous impact" of the "indubitable equivalence" standard on the family farmer's reorganization prospects, and cautioned against extension of an "indubitable equivalence" standard beyond the strict confines of the statute.[11]

The Supreme Court in *Timbers* expressly rejected extension of the "indubitable equivalence" standard in the context of "adequate protection" to undersecured creditors under 11 U.S.C. § 362(d)(1). According to the Supreme Court in *Timbers*:

> The crux of the present dispute is that petitioner asserts . . . that the phrase 'interest in property' also includes the secured party's right (suspended by the stay) to take immediate possession of the defaulted security, and apply it in payment of the debt.

484 U.S. at 370-71, 108 S. Ct. at 630, 98 L.Ed. 2d at 748.

[11] Critics of the "coerced loan" method caution that the secured creditor could present expert testimony that no lender would make a loan which is compatible to the creditor's treatment under the proposed plan, only to propose an extreme rate of interest that a lender would require if it were to make such a loan. *See In re Village Associates*, 161 B.R. 127 (Bankr. E.D. Pa. 1993), aff'd, 181 B.R. 795 (D.E.D. Pa. 1995). Under such scenarios, the cramdown provision is rendered a nullity.

The Supreme Court in *Timbers* concluded that, in order for an undersecured creditor to be entitled to compensate for the delay in the creditor's right to take immediate possession of the collateral and to reinvest the proceeds,[12] the adequate protection provision at § 361(3) would need to expressly provide the creditor "such other relief... as will give such entity, *as of the date of the relief*, the indubitable equivalent of such entity's interest in such property." *Id.*[13]

Given the statutory clarity that the Supreme Court in *Timbers* would have required for according "indubitable equivalence" to an undersecured creditor in the context of adequate protection, one can only conclude that the Supreme Court would find no statutory basis to require payment of "indubitable equivalence" under § 1325(a)(5)(B)(ii).[14]

[12] Creditor in the present case similarly demands compensation for the "lost opportunity" to take immediate possession of the security and to reinvest the proceeds.

[13] The significance of the Supreme Court's decision to deny indubitable equivalence payments is heightened by the fact that, unlike the cramdown statute in the present case, the statute at issue in *Timbers* actually included "indubitable equivalent" language that the Court did not deem sufficiently specific.

[14] It is difficult to reconcile the result in *Timbers* with the Court's conclusion that the creditor is entitled to a rate of interest which will place it in as good a position as if it had been allowed to immediately repossess and reinvest the proceeds, Slip Op. at 14-16, because the cramdown statute contains no such requirement. The primary cases upon which the majority relies, e.g., *Koopmans*, *supra*, 102 F.3d at 874-75, and *GMAC v. Jones*, *supra* 999 F.2d at 66-71, similarly fail to conform with the *Timbers* result. The Timbers case has been viewed as significant in the cramdown context since adequate protection was determined not to encompass prevention of the creditor's lost opportunity costs. The concepts of "present value" and "adequate protection" are considered analogous, since both serve to protect the *status quo and nothing more*. *In re Collins*, 167 B.R. 842, 845-46 (Bankr.E.D.Tx. 1994).

III. CONCLUSION AND PRAYER FOR RELIEF

As evidenced by the 10-page dissent, the Court's decision is highly controversial and inexplicably at odds with the rehabilitative purpose of Chapter 13. The secured creditor is preferred at the expense of the debtor and other unsecured creditors in a federal system of bankruptcy intended to equitably apportion a debtor's limited assets. The decision has devastating consequences for Chapter 13 debtors like the debtors in the present case, who have struggled to maintain plan payments on a tight budget; it impedes the uniform application of "present value" concepts throughout the Code, and calls into question the continued viability of Chapter 13 cramdown—the very device that Congress provided debtors as a means to modify secured creditors' contractual rights and retain collateral essential to an effective reorganization.

En banc courts have the unique opportunity to determine the "major doctrinal trends" for their respective circuits. In the present case, en banc review will enable the Court to rectify an improper judicial expansion of the "indubitable equivalence" standard to Chapter 13 cramdown, and to return the cramdown interest analysis to the "present value" concept contemplated by the statute. Such action may thwart the needless confusion and litigation that will inevitably result in courts throughout this Circuit faced with the formidable task of applying the decision in its present form. Petitioners respectfully request that the Court reconsider its decision,

grant this petition for rehearing en banc, restore this case to the calendar for reargument or resubmission, or grant such other relief deemed appropriate by the Court.

Respectfully submitted,

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PROOF OF SERVICE

The undersigned hereby certifies that two copies of the foregoing Petition for Rehearing En Banc with attached Appendix, were served to the following: John M. Smith, 214 West Marion Street, Elkhart, IN 46516, together with a copy of the digital media (disk), and that one copy of the Petition for Rehearing En Banc with attached Appendix was served to each of the following: Robert Brothers, Trustee, 151 North Delaware Street, Suite 1400, Indianapolis, IN 46204; and the office of the U.S. Trustee, 101 West Ohio Street, Suite 1000, Indianapolis, IN 46204, by U.S. First Class Mail, postage prepaid, this 3rd day of September, 2002.

_____

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In the Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

PETITIONERS' BRIEF ON THE MERITS

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QUESTIONS PRESENTED

1. Is an undersecured creditor entitled to the "indubitable equivalent" of its nonbankruptcy entitlement for purposes of discounting deferred payments to present value under the Chapter 13 cramdown provision at 11 U.S.C. § 1325(a)(5)(B)(ii), resulting in fixing of a subprime lender's 21% contract rate as the presumptive discount rate?

2. What is the proper method for discounting of deferred payments to present value on property retained by the debtor under the Chapter 13 cramdown provision, and what is the creditor entitled to be compensated for in calculating the appropriate discount rate of interest?

PARTIES AND RULE 29.6 STATEMENT

Petitioners

Petitioners Lee M. Till and Amy M. Till are individual citizens of the United States residing in the Southern District of Indiana. Neither Petitioner has corporate affiliations. Lee M. Till and Amy M. Till were the debtors in the Bankruptcy Court, the Appellees in the District Court and the Appellants in the Seventh Circuit Court of Appeals.

Respondent

Respondent SCS Creditor Corporation is a corporation with no parent corporation. Petitioners are unaware of any publicly held company owning ten (10%) percent or more of said corporation's stock. SCS Credit Corporation was the objecting creditor in the Bankruptcy Court, the Appellant in the District Court, and the Appellee in the Seventh Circuit Court of Appeals.

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OPINIONS BELOW

The panel opinion of the United States Court of Appeals for the Seventh Circuit (Pet. App. B at 3a) was entered on August 21, 2002 and is reported at 301 F.3d 583 (7th Cir. 2002). The Order denying petition for rehearing *en banc* (Pet. App. A at 1a) was entered by the Seventh Circuit Court of Appeals on October 10, 2002 and is reported at 2002 U.S. App. LEXIS 21282 (7th Cir. 2002). The unreported opinion of the United States District Court for the Southern District of Indiana (Pet. App. C at 34a) was issued on November 1, 2000. The unreported order of the United States Bankruptcy Court for the Southern District of Indiana (Pet. App. D at 40a) was issued on June 27, 2000.

JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1). The judgment of the Seventh Circuit Court of Appeals was entered on August 21, 2002. The Court of Appeals entered an order denying a timely petition for rehearing *en banc* on October 10, 2002 (Pet. App. A at 1a). The petition for writ of certiorari was filed on January 2, 2003, and was granted on June 16, 2003.

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 1322(b)(2) provides:

* * * *

(b) Subject to subsections (a) and (c) of this section, the plan may —

* * * *

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in

real property that is the debtor's principal residence, ...[1]

11 U.S.C. § 1325(a)(5) provides:

(a) Except as provided in subsection (b), the court shall confirm a plan if—

* * * *

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan,[2] of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; ...

STATEMENT OF THE CASE

Lee M. Till and Amy M. Till filed a petition for relief under Chapter 13, Title 11 of the United States Code on October 25, 1999. The underlying facts are not disputed. SCS Credit Corporation ("SCS") held a perfected security interest in the debtors' 1991 S-10 truck ("vehicle") retained by the debtors strictly for personal use. The amount financed under SCS's original contract dated October 2, 1998 (Jt. App. at 21) was $6,425.00, with a total sale price of $8,385.24 (including interest at the rate of 21% per annum). The principal balance on the contract as of the petition date was $4,894.89, based upon SCS's proof of claim (Jt. App. at 15-18). The "cramdown" value of the vehicle was established by agreement at $4,000.00. The proposed three-year Chapter 13 plan provided for payments by wage assignment to the Trustee in the total amount of $740.00 per month. SCS's allowed secured claim was to be paid in full concurrently with payments on other allowed secured claims, with a discount factor of 9.5 % to be paid on the declining balance of the $4,000.00 allowed secured claim from the date of confirmation (Pet. App. G at 77a-79a). The 9.5 % discount rate proposed by the debtors was based on a "formula method" (Pet. App. D at 43a) consisting of the prime rate (as of petition date) as a base, with addition of a 1.5% risk premium ("prime-plus"). SCS objected to confirmation of the plan, arguing that, under the "coerced loan" method of discounting to present value, SCS was entitled as a "subprime" lender to its 21% contract rate of interest to compensate for the return on its investment if it were permitted to foreclose on the vehicle and reinvest the proceeds in a like-kind loan (Pet. App. D at 41a).

A hearing limited to the rate of interest to be paid on SCS's allowed secured claim under 11 U.S.C. § 1325(a)(5)(B)(ii) was conducted before the bankruptcy court on February 29, 2000 (Pet. App. at 57a). The debtors' expert, a professor with a Ph.D in economics and former economist in the research department of the St. Louis branch of the Federal Reserve Bank, testified that standard lending institutions use the "prime rate," described as part of a "uniform national market" and a "national benchmark rate." According to the economist's

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[1] Unless otherwise indicated, any reference to "secured claim" throughout this brief shall be deemed to exclude any claim secured only by a security interest in property that is the debtor's principal residence.

[2] The "value, as of the effective date of the plan" language is used as a term of art in the reorganization chapters to refer to process of discounting deferred payments to present value. *See, e.g.*, (Pet. App. E).

unrebutted testimony, the "prime rate" not only accounts for the time-value of money ("a dollar now is a little more valuable that a dollar later") which the expert projected at 3.5%, but also includes adjustment for the purchasing power of the dollar (inflation rate projected at 2.5%), as well as risk and transaction costs (accounting for the 2% balance of the 8% prime rate) (Pet. App. F at 63a-64a). SCS's general manager testified that SCS does not sell vehicles on credit for a rate of interest less than 21%, and that 21% was the rate charged by other lenders in the area. (Pet. App. F at 73a). Furthermore, SCS's representative stressed that SCS and other non-prime lenders "do not like" Chapter 13 petitions because creditors often encounter delay and fail to receive full payment (Pet. App. F at 73a-74a). The Trustee recommended a "formula method" previously adopted by the courts in that district. (Pet. App. F at 60a-62a).

The Bankruptcy Court rejected the notion that the discount factor should be tied to the creditor's subprime lending status, and interpreted *Koopmans v. Farm Credit Services of Mid-America*, ACA, 102 F.3d 874 (7th Cir. 1996), to afford the court discretion to adopt the prime-plus 1.5% rate ultimately approved by the court. The matter before the Bankruptcy Court was a core proceeding within the meaning of 28 U.S.C. § 157(b)(2)(L). Exercising jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1) and 1334, the Bankruptcy Court confirmed the amended Chapter 13 plan (Pet. App. D at 42a-43a).

SCS timely appealed the final order approving confirmation of the plan to the United States District Court for the Southern District of Indiana, Indianapolis Division, which exercised jurisdiction pursuant to 28 U.S.C. §§ 158(a) and 1334. The District Court reversed the Bankruptcy Court on the basis that unrebutted evidence established that a "subprime" market existed and that the established rate for the subprime lending market was 21%, which the District Court considered

the controlling inquiry under *Koopmans* (Pet. App. C at 38a). The District Court reasoned that because the Tills are in the nonprime market, they are presumably "risky debtors." (Pet. App. at 36a). According to the District Court, the changed nature of the risk of a loan once it becomes part of a Chapter 13 plan is irrelevant. (Pet. App. C at 38a).

The District Court considered the determination of the correct interest rate under § 1325(a)(5)(B)(ii) to be a "factual determination" that would not be disturbed if the bankruptcy judge's inferences are reasonable and supported by the evidence. Under the District Court's ruling, the Bankruptcy Court had no discretion to adopt the "prime plus" discount rate. (Pet. App. C at 37a).

The debtors appealed the District Court decision to the Seventh Circuit. The majority panel of judges assigned to the case interpreted *Koopmans* to mandate a "coerced loan" approach. Conceptualizing the cramdown process as forcing the creditor to extend a new line of credit to the debtor, the majority panel reasoned that "the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk", since nothing less would give the creditor the "indubitable equivalent" of its nonbankruptcy entitlement (Pet. App. B at 17a-18a). Adopting *GMAC v. Jones*, 999 F. 2d 63 (3d Cir. 1993), the majority panel concluded that the "old contract rate will yield a rate sufficiently reflective of the value of the collateral at the time of the effectiveness of the plan to serve as a presumptive rate." (Pet. App. B at 20a).

Tills timely petitioned for rehearing *en banc* (Jt. App. at 59), which was denied on October 10, 2002.

SUMMARY OF THE ARGUMENT

The majority panel below established a "rebuttable presumption" in favor of the subprime lender's 21% contract

rate for purposes of discounting deferred payments to present value at 11 U.S.C. § 1325(a)(5)(B)(ii).

Interest rates can determine the success or failure of a debtor's Chapter 13 plan.[3] The majority panel's decision defeats a fundamental purpose of Chapter 13 to enable all individuals who qualify for Chapter 13 relief under 11 U.S.C. § 109(e) to retain basic necessities -- not just those individuals who happen to be "prime" lending candidates.

The issue of allowability of interest on claims against a debtor's estate is uniquely concerned with the equitable distribution of a debtor's limited assets, and has long been determined by federal law. *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 162-63 (1946). Because the coerced loan approach results in such vast disparity of treatment amongst creditors, the controversy generated by the decision of the majority below is often characterized as a dispute amongst creditors rather than a debtor-creditor debate.

Congress frequently rewards certain individuals and groups with favorable interest rates. Debtors under Chapter 13 are among those singled out for special treatment under 11 U.S.C. § 1325(a)(5)(B)(ii). Consumer bankruptcy reform was considered a fundamental objective of the Bankruptcy Reform Act of 1978 ("Code"). P.L. No. 95-598, 92 Stat. 2549. Under former Chapter XIII of the Chandler Bankruptcy Act ("Act"),

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[3] Payment of an allowed secured claim in an amount of $15,000.00 at 9.5% interest (the rate adopted by the Bankruptcy Court in the case below) over the maximum five-year plan term requires base funding in an amount of approx. $18,753.00 @ $312.55/month, whereas payment of $15,000.00 at 21% over the same period requires base funding of $23,929.20 @ $398.82/month -- a staggering $5,176.20 increase in interest exclusive of the additional trustee fees generated thereon. This is typically either $5,176.20 that the debtor doesn't have -- or a $5,176.20 windfall to the subprime lender at the expense of unsecured creditors.

the court could confirm a Chapter XIII plan only if the plan had been accepted by all secured creditors whose claims were dealt with by the plan. *See* § 651 of the Chandler Act, 52 Stat. 840-940, P.L. 696, June 22, 1938. Chapter XIII was of very limited utility to debtors attempting to deal with claims secured by personal property. The generous cramdown provisions of present Chapter 13 were enacted in direct response to this problem. The Code represented a significant impairment of the rights that secured creditors had enjoyed under the Act. For the first time, under §§ 1322(b)(2) and 1325(a)(5)(B)(ii), individual debtors could modify a secured creditor's pre-petition contract rights over the creditor's objection. The coerced loan method adopted by the Seventh Circuit is "inexplicably hostile to Chapter 13 and its rehabilitative intent." Lundin, 2 Chapter 13 Bankruptcy, § 112.1 at 112-16 (3d ed. 2000).

Pursuant to 11 U.S.C. § 506(a), the amount of the creditor's "allowed secured claim" for purposes of § 1325(a)(5)(B)(ii) is measured by the value of the collateral.[4] Section 1325(a)(5)(B)(ii) addresses only the allowed secured portion of the creditor's claim -- not the entire state-law contract balance.

Section 1325(a)(5)(B)(ii) thus involves the process of *converting collateral (allowed secured claim) into a stream of deferred cash payments.* This statutory process is universally recognized to require a "present value" or "time value of money" analysis.[5]

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[4] An undersecured creditor, such as SCS, also has an unsecured claim in an amount by which the creditor's claim exceeds the value of the collateral pursuant to 11 U.S.C. § 506(b).

[5] This Court in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), noted that the debtor under §1325(a)(5)(B)(ii) is required to provide the creditor with payments, over the life of the plan, that will total the

The decisions of numerous Circuits, including the Seventh Circuit below, have transformed this mechanical process of calculating the "present value" of the "allowed secured claim" into a fact-specific inquiry into a particular creditor's use of interest as a vehicle for profit in the nonbankruptcy marketplace. Under the "coerced loan" or "presumptive contract" theories, the subprime lender, charging nonbankruptcy rates as high as 40% in some states,[6] becomes a new class of preferred creditor who stands to profit immensely by reaping an unfair share of the estate's limited assets -- all at the expense of general unsecured claimants and the debtor's successful rehabilitation. Empirical data demonstrates that years after the cramdown section was enacted, secured claimants under Chapter 13 receive by far the lion's share of the estate's assets, to the exclusion of unsecured creditors.

The "coerced loan" theory "profoundly misstates" the present value concept at 11 U.S.C. § 1325(a)(5)(B)(ii). *In re Dingley*, 189 B.R. 264, 268-69 (Bankr. N.D. N.Y. 1995). The "coerced loan" or "presumptive contract" cases are based on fictional premises. There are no *loans* in the Chapter 13 cramdown statute — only "*claims.*" Not defined in the

"present value" of the "allowed secured claim," i.e., the "present value of the collateral ...." 520 U.S. at 957. Similarly, this Court in *Rake v. Wade*, 508 U.S. 464 (1993) noted that deferred cash payments under § 1325(a)(5)(B)(ii) must equal the "present dollar value" of the allowed secured claim as of the confirmation date, which implies the payment of interest. 508 U.S. 469-70.

6 *See, e.g.*, Scott F. Norberg, "Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13," 68 Am.Bankr. Inst. L. Rev. 415, 438-39 (1999), noting that secured creditors under the cramdown provision are now presumptively entitled to interest at rates that range as high as 40% in a state like Mississippi where there is currently no legal usury rate. Miss. Code Ann. § 75-17-1.

Bankruptcy Code, a "loan" typically includes an obligation to pay *contractual* interest. There is no "market rate" for a bankruptcy "loan," because pre-petition loans become "claims" upon filing of bankruptcy. A cramdown is neither contractual, consensual nor a loan -- but rather exclusively a creature of federal statute. The purpose of cramdown is not to compensate the creditor for unrealized contract damages or profit, but rather to equate the *value of the debt* with the *value of the allowed secured claim*. 124 Cong. Rec. H11,103 (daily ed. Sept. 28, 1978)(remarks of Rep. Don Edwards); 124 Cong. Rec. S17,420 (Oct. 6, 1978)(remarks of Rep. DeConcini).

Petitioners contend that the "coerced loan" or "presumptive contract" approaches mandated by the majority panel below are prohibited by the plain language and structure of the statute. Once the myriad of inappropriate fact-specific characteristics are removed from the "present value" equation, discounting of payments to present value under § 1325(a)(5)(B)(ii) becomes a straightforward process that lends itself to predictable results. Petitioners do not contend that there is but one formula by which payments may be discounted to present value under § 1325(a)(5)(B)(ii) — or one discount rate to be applied in every case. Bankruptcy courts are thus left with discretion to apply one of various formula methods, which take into account only those factors appropriate to the statutory discounting process.[7]

ARGUMENT

Because of the mechanical nature of the present value calculation, the court in *In re Oaks Partners, LTD*, 135 B.R. 440, 445 (Bankr. N.D. Ga. 1991) noted that, the "*time value of*

7 The range of permissible results will be dramatically reduced by this process, with a substantial increase in uniformity and predictability, and a corresponding decrease in costly litigation and waste of limited judicial resources.

money" approach is commonly referred to as the "*formula*" approach urged by Petitioners.

The Seventh Circuit is not alone in its adoption of the alternate "coerced loan" method of discounting to present value. The Seventh Circuit adopted the holding of the Third Circuit in *GMAC v. Jones*, *supra*, 999 F.2d 63, and several other Circuits have adopted variations of the "coerced loan" method. *Matter of Southern States Motor Inns, Inc.*, 709 F.2d 647 (11th Cir. 1983), *cert. den.*, 465 U.S. 1022 (1984); *In re Hardzog*, 901 F.2d 858 (10th Cir. 1990); *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993); and *In re Smithwick*, 121 F.3d 211 (5th Cir. 1997), *cert. den.*, 523 U.S. 1074 (1998); *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989).[8]

In contrast, the Second, Eighth and Ninth Circuit Courts of Appeals have adopted one of various "formula" methods for discounting payments to present value. Under a "formula" method, the court adopts a readily accessible or national risk-free rate of interest as a base, to which a "risk premium" is added at the court's discretion corresponding to the court's determination of any special risks associated with the reorganization plan. *United States v. Doud*, 869 F.2d 1144 (8th Cir. 1989)[Chapter 12]; *In re Fowler*, 903 F.2d 694 (9th Cir. 1990)[Chapter 12]; and *In re Valenti*, 105 F.3d 55 (2d Cir. 1997)[Chapter 13][abrogated on other grounds by *Rash*, *supra*, 520 U.S. 953].

Petitioners contend that the most direct method to arrive at an appropriate discount factor is use of a formula method with

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[8] The continued viability of the "coerced loan" method of discounting to present value in the Sixth Circuit is called into serious question by the most recent Circuit case of *In re Kidd*, 315 F. 3d 671 (6th Cir. 2003), in which the Sixth Circuit Court of Appeals flatly rejected the 20.95% subprime contract rate.

a readily accessible national rate base. If the chosen national rate is truly risk-free, a risk premium may be added at the discretion of the bankruptcy court upon the creditor's demonstration of uncompensated risk. On the other hand, an additional risk premium may be unnecessary — for instance, because the chosen national rate already includes a risk allowance, or because the higher *Rash* replacement value has eliminated the necessity for inclusion of an additional risk premium.

I. CHAPTER 13 EXPRESSLY PERMITS MODIFICATION OF CONTRACTUAL INTEREST RATES IN EXCHANGE FOR PAYMENT OF THE ALLOWED SECURED CLAIM AT STATUTORY PRESENT VALUE

A. Historic Concept of Discounting of Deferred Cash Payments to Present Value

Although Congress neither established a single discount rate applicable to all bankruptcy cases nor specified a particular method for determining an appropriate discount rate under 11 U.S.C. § 1325(a)(5)(B)(ii), the legislative history of the cramdown sections describes the mechanical process of determining present value in a manner consistent with the use of the term by the economic and financial communities. H.R. Rep. No. 95-595, U.S. Code Cong. & Admin. News 1978, p. 6464, as appearing in 2 Appendix *Collier on Bankruptcy* at 408; H.R. Rep. No. 95-595, 95th Cong., 1st Sess., 414-15 (1997).

"Present value" or the "time value of money" is not a legal concept, but rather a term of art in the financial community. The present value rule dates back to the work of the great American economist Irving Fisher in 1930. Irving Fisher, The Theory of Interest (1st ed. 1930). To compensate the creditor for not receiving its money (i.e., value of collateral or allowed

secured claim) today, the debtor is charged an additional amount of money based on a rate of interest called a "discount rate." E. Grant & W. Ireson, Principles of Engineering Economy 35 (4th ed. 1964). As explained by Robert W. Hamilton in Fundamentals of Modern Business (4th ed. 1989), relatively simple "formulae" permit a direct comparison of the value of amounts to be paid at different times. The process by which amounts payable at different times are made comparable is referred to as "discounting" or reducing future payments to present value; *Id.* at p. 29. When speaking of the earning power of a present amount over time, one usually speaks of the "interest rate." When computing the "present value" of a future payment, one usually speaks of the "discount rate;" however, it is the same rate since the "present value" of a future sum and the "future value" of a present sum involve precisely the same calculation examined from opposite perspectives. *Id.* at p. 30.[9]

Paul A. Samuelson, in his renowned treatise, defined "market rate of interest" as follows:

> *Definition*: The market rate of interest is that percentage return per year which has to be paid on any safe loan of money, which has to be yielded by any safe bond or other security, and which has to be earned on the value of any capital asset (such as a machine…) in any competitive market where there are no risks or where all risks have already been taken care of by special premium payments to protect against risk.[10]

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[9] Present value is easily computed by reference to readily available financial tables. J. Weston and E. Brigham, Managerial Finance 244-71 (6th ed. 1978).

[10] Economists historically use the term "market rate of interest" to mean the pace at which the national economy flows based on supply and demand.

Paul A. Samuelson, Economics 575 (8th ed. 1970).

Present value as understood at the time of adoption of § 1325(a)(5)(B)(ii) and as understood now is defined by economics as the discount to present value of a payment stream using a riskless rate plus some risk premium related to the payment stream in question. A "risk-adjusted discount rate" is thus defined in economics as follows:

> …the risk-free rate (generally the return on short-term U.S Treasury securities) plus a risk premium that is based on an analysis of the characteristics of the particular investment or project.

John Downes and Jordan Elliott Goodman, Dictionary of Finance and Investment Terms 594 (6th ed. 2003).

Similarly, "discount rate" is defined as the:

"Coerced loan" theorists redefine "market rate of interest" as the rate the lender charges to similarly situated borrowers in the lender's particular (e.g., "subprime") market. Petitioners contend that there is a difference between applying a "market rate of interest," as opposed to calculating present value by use of a risk-free base (e.g. treasury bill rate) that is "market" sensitive. One illustration of this distinction is the fact that 11 U.S.C. § 362(d)(3)(B) specifies that interest is to be paid at the current "market rate" ("market rate" being the end result). In contrast, the Code sections contemplating a "present value" calculation do not specify interest to be paid at "market rate," and a market-sensitive risk-free base is merely a means to an end (present value being the end result). The labeling of the interest to be paid at § 1325(a)(5)(B)(ii) as "market rate" interest is a misnomer which has led to extreme variations in the discounting process as a result of each lender's attempt to establish its "market" as controlling. The "coerced loan" approach introduces characteristics of the submarket for loans in a particular industry, wholly irrelevant to the value of the secured creditor's interest in the collateral. A lender in the lucrative subprime lending market can thus reap cramdown interest rates of 20-40% unprecedented in present-value calculations in the economic community.

1. interest rate that the Federal Reserve charges member banks for loans, using government securities…as collateral. This provides a floor on interest rates, since banks set their loan rates a notch above the discount rate ….

2. interest rate used in determining the PRESENT VALUE of future CASH FLOWS ….

Id. at 181 (emphasis in original).

(Advent of Subprime Lending and Establishment of Finance Company Affiliates by Major Auto Manufacturers in the Non-Bankruptcy Marketplace)

Following enactment of the Code, it was several years before the "coerced loan" method with its statutory embellishments took root.

Then, in the late eighties and early nineties, automobile lending began to become extremely lucrative. Virtually every major auto manufacturer established a lending arm.[11] These finance company affiliates of the major auto manufacturers have made auto loans with rates as low as 0%[12] and recouped

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[11] In December 1996, Ford Motor Credit Company announced an ambitious plan to extend its lending reach into the "subprime" lending market. The reported lure was the $100 billion that consumers with flawed credit ratings borrow each year to buy new and used cars, and the interest rates of 18-40% that such lenders charge on loans in that market — the equivalent of paying for a car at credit card rates. Robyn Meredith, "Financial Powerhouse Takes Aim at Bad Credit Risks," New York Times (December 15, 1996). The credit industry thus campaigns to tighten debtor access to bankruptcy relief even as it expands its high-risk lending practices.

[12] Such contracts result in a presumption of "0%" cramdown interest under the majority panel's incongruous analysis. A similar dilemma was posed by Judge Lundin:

this credit subsidy to borrowers by receiving "subvention" payments from the auto manufacturers and auto dealers. "The Separation of Banking and Commerce," http://www.public-gis.org/reports/sbc.html (p.11).

Some evidence suggests that auto company use of credit to promote auto sales has resulted in an overall deterioration of credit standards in the auto loan market, affecting auto loans made by banks as well as captive finance companies. In recent years, auto loans with five-year terms have become commonplace, yet, such auto financing entails considerable risk since on average the borrower has no equity in the financed auto until the 37th month after purchase. *Id.* at p. 43.[13] In the case of an auto purchase with subsidized credit, both the subvention payment and cash rebate indirectly raise the purchase price and are considered part of the purchase price on the cut-rate auto loan, resulting in imposition of higher costs on less sophisticated consumers. *Id.* at p. 44. A lender

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> If GMAC was running a '1.9 APR special' alongside a 'standard' 20 percent car loan, is the promotional rate ignored for § 1325(a)(5) purposes….? On careful scrutiny, most lenders offer many different 'regular' interest rates for the same loan. Does [this] require the bankruptcy courts … to parse through every lender's portfolio to find the right market rate; and if so, on what logic would a bankruptcy court include some available rates and reject others?

Lundin, 2 Chapter 13 Bankruptcy § 112.1 at 112-20 - 112-21 (3d. ed. 2000).

[13] The American Bankers Assoc. reported that the delinquency rate on banks' indirect auto loans (loans through auto dealers) was 47% higher than the delinquency rate on auto loans made directly by the banks; according to the Consumer Bankers Assoc., intense competitive pressures in the auto loan market have forced banks to resort to indirect lending, which now accounts for 78% of auto loans made by banks. "The Separation of Banking and Commerce," *supra*, http://www.public-gis.org/reports/sbc.html(p.43).

typically structures its loan repayment to accommodate the possibility that the value of the collateral may ultimately be less than the balance due on its note.

From the 1990s to present, there has similarly been a tremendous growth in the "subprime" lending market. Subprime borrowers typically have at least one serious blemish on their credit history, or no credit history at all. The former group might have significantly impaired credit histories with multiple delinquencies and charge-offs, as well as relatively low household incomes of $20,000.00 - $40,000.00 annually. The latter group might include recently divorced or separated persons who do not have an independent credit history. Annual originations of subprime auto loans range from $40 billion to $70 billion, or between one-tenth and one-sixth of total auto finance originations. Most companies in this sector finance loans ranging between $5,000.00 - $14,000.00. The adjusted periodic rates (APRs) to borrowers generally exceed 15% and averaged 22% (as of 1998) for the entire subprime industry, capped by local state usury laws. However, many of these loans are purchased at discount, which effectively takes the yield over state usury caps. "Subprime Auto Finance: The Year of the Bankruptcies" (ABI Journal May 1998), http://www.abiworld.org/abidata/online/journaltext/98myturn.html.[14] Inherent in the panel majority's presumptive-contract

[14] "Predatory loans" are a subset of subprime loans. A "predatory loan" typically has one or more of the following features: 1) charges more in interest and fees than is required to cover the added risk of lending to borrowers with credit imperfections; 2) contains abusive terms that trap borrowers and lead to increased indebtedness; 3) fails to take into account the borrower's ability to repay the loan, and/or 4) violates fair lending laws by targeting senior citizens, women, and minorities. National Community Reinvestment Coalition Position Paper on Predatory Lending, "Subprime and Predatory Lending Defined," http://www.ncrc.org. It is generally recognized that, while most subprime loans are not predatory, the subprime

approach is the advocacy of a highly suspect national policy -- that those lenders who are more successful at interest-rate gouging will be rewarded to the detriment of other creditors in the common pool.

There is also evidence that the higher interest rates charged by subprime lenders cannot be fully explained solely as a function of the "additional risks" presented by these loans. Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, Subprime Lending: An Investigation of Economic Efficiency, Freddie Mac, 2000. Also, analyses by Fannie Mae and Freddie Mac suggest that subprime lending is occurring with borrowers whose credit would in fact qualify them for conventional loans. Center for Community Change, October 17, 2001, http://www.communitychange.org.[15]

The advent of subprime lending and the establishment of finance company affiliates of the major auto lenders has thus effectuated a major change in pre-bankruptcy lending dynamics that make traditional assumptions concerning the pre-bankruptcy fixing of interest rates highly unreliable. This turmoil in the non-bankruptcy marketplace further

market is fertile ground for predatory lending. *See, e.g.*, Center for Community Change, October 17, 2001, http://www.communitychange.org.

[15] It has been estimated that 25%-30% of subprime borrowers would qualify for conventional loans. *See, e.g.* Ron Elwood, Legal Services Advocacy Project, "State and National Eyes Focused on Predatory Lending," Minnesota Legal Services Coalition, http://www.mnlegalservices.org/lsap//end.shtml. The District Court's rationale that the Tills' status as subprime borrowers justifies discriminatory treatment under the Bankruptcy Code is particularly troubling. See District Court Order (Pet. App. A at 36a), where the District Court stated: "Potential borrowers are in this non-prime market because their credit histories are poor and they are therefore risky debtors. Presumably these borrowers cannot find a lender in the prime market."

demonstrates the perils of attempting to incorporate pre-bankruptcy lending practices into a uniform federal statute such as the Bankruptcy Code.

B. The Plain Meaning of Section 1325(a)(5)(B)(ii) Supports Petitioners' Interpretation of the Statute

Beginning with the statutory language, it is apparent that Congress described the obligation to pay plan interest under the reorganization chapters in very different terms from the obligation to pay pendency interest under § 506(b), which refers to "…fees, costs or other charges provided for under the agreement under which such claim arose." Section 362(d)(3)(B) addresses the period prior to confirmation, when a debtor is required to pay interest at the current fair "market rate" on the value of the secured claimant's interest in the real estate. The fair "market rate" language at § 362(d)(3)(B) suggests a retail rate available to the owner of similar real estate in that particular market. Robert G. Quila, "Cramdown Interest Rate: Second Circuit Court of Appeals Addresses What It Is and What It Is Not," 6 J. Bankr. L & Prac. 549, 555 (1997). Therefore, one must conclude that the present value discount required under the cramdown provision is something different from the current retail "market rate."[16] *Id.* at 556. A "plain language" interpretation of the statute suggests a simple payment stream discounted to reflect the present value of the "allowed secured claim" in a fixed amount, without any additional creditor-debtor fact-based considerations. Michael E.S. Frankel, "The Emerging Fixed Cramdown Rate Regime: A Market-Driven Argument for Effective Fixed Rates in

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[16] The legislative history of the cramdown provisions of the Bankruptcy Reform Act refers to "the discount rate" rather than a "market rate of interest." S. Rep. No. 989, 95th Cong., 2d Sess. 414-15 (1978), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6370-71.

Bankruptcy Cramdown," 2 Chi. L. Sch. Roundtable 643 n.75 (1995).

Under common rules of construction, where a word or term has a judicially settled meaning, it must be presumed that Congress has used it in that sense where it appears in a statute. *Gilbert v. United States*, 370 U.S. 650, 655 (1962). Congress speaks with careful precision, and its words mark the exact spot at which it stops. *The Scotland*, 118 U.S. 507 (1886). It is at once apparent that § 1325(a)(5)(B)(ii) contains none of the "words" essential to the "coerced l*oan*" and "presumed *contract*" theories — no use of the word "contract," "loan," or "market rate."

C. Petitioners' Present Value Interpretation is Consistent with the Structure of Chapter 13

As noted by this Court in *United Savings Ass'n v. Timbers of Inwood Forest Associates*, 484 U.S. 365, 371 (1988), a provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme.

Not only is the "present value" language used throughout the reorganization chapters, but only the Petitioners' interpretation produces a substantive effect compatible with the rest of the Code.

Section 1325(a)(5)(B)(ii) is the very statute by which the § 1322(b)(2) right of contract modification is implemented. By imposing a rebuttable presumption in favor of the pre-petition contract rate under § 1325(a)(5)(B)(ii), the majority panel below creates irreconcilable conflict between the two statutes and renders the § 1322(b)(2) modification rights unworkable. This Court in *Citizens of Maryland v. Strumpf*, 516 U.S. 16, 20 (1995) cautioned against such convoluted interpretation of a statute, "[w]hen [a] perfectly reasonable reading [of the Code] is available…" Surely one of the most fundamental rights afforded to debtors under Chapter 13 cannot so readily be

eliminated by the Court under a construction at odds with all other "present value" language in the Code and not expressed anywhere in the statute.[17]

The "coerced loan" approach upsets the symmetry of the Code in other critical respects. 11 U.S.C. § 506(b) allows an oversecured creditor to add interest that accumulates prior to confirmation to the secured claim awaiting distribution under the debtor's plan. The post-petition interest under § 506(b) becomes part of the secured claim and may accrue until the effective date of the plan. Upon confirmation, § 1325(a)(5)(B)(ii) requires that payments made under the plan return the "present value" of the § 506(b) secured claim amount to the creditor. In the case of an oversecured creditor, §§ 506(b) and 1325(a)(5)(B)(ii) compliment each other and together ensure the full payment of the present value of the secured creditor's claim. *In re Harko*, 211 B.R. 116, 123 (2d Cir. BAP 1997), *aff'd*, 141 F. 3d 420 (2d Cir. 1998), *cert.den.*, 525 U.S. 872 (1998). As a result of the reference to the "agreement under which such claim arose" at § 506(b), the contract rate of interest is frequently applied under § 506(b). Under the majority panel's interpretation of § 1325(a)(5)(B)(ii), certain classes of secured creditors (e.g. subprime lenders) are singled out for special treatment over prime lenders and oversecured creditors whose secured claims

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[17] Under the Bankruptcy Act, safeguards were provided to protect the rights of secured creditors only to the extent of the value of their property, and there was no constitutional claim of the creditor to insist that the statute required anything more; this Court recognized that the Act must be liberally construed to give the debtor the full measure of the relief afforded by Congress. *John Hancock Mutual Life Ins. Co. v. Bartels*, 308 U.S. 180, 186-87 (1939).

arise from statute.[18] The substitution of a contract rate of interest for "present value" interest under § 1325(a)(5)(B)(ii) ignores the different objectives of these two sections.

Under 11 U.S.C. § 1325(a), the court "shall" confirm the plan if certain minimal requirements for confirmation are met. Under § 1325(a)(5)(A), the debtor need not satisfy § 1325(a)(5)(B) if the creditor fails to object to the plan. Requiring the debtor to "come forward with evidence" to support any below-contract interest rate renders § 1325(a)(5)(A) a nullity.

It is a well-recognized canon of construction that words repeated within the same statutory section have an identical meaning in the several places employed. *George Van Camp & Sons Co. v. American Can Co.*, 278 U.S. 245 (1929). The "value, as of the effective date of the plan" language appears throughout the reorganization chapters (Pet. App. E at 45a-51a), and has consistently been interpreted under a "present value" analysis to require that payments be adjusted "to allow for the changing value of a dollar". *See*, e.g., *United States v. Neal Pharmacal Co.*, 789 F. 2d 1283 (8th Cir. 1986) [method for determining proper discount rate is same under § 1129(a)(9)(C) for unsecured tax claims as § 1129(a)(7) for secured cramdown]. In sharp contrast, under the majority panel's ruling, every unsecured claimant would be entitled to a different interest rate based on its contract or lending market when a debtor must pay "value, as of the effective date of the plan" to unsecured claimants to satisfy the best-interests-of-creditors test under § 1325(a)(4). Lundin, 2 Chapter 13 Bankruptcy § 112.1 at 112-8 (3d. ed. 2000). To impose a fact-specific interpretation on the present-value calculations

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[18] Contrast the 21% presumptive interest rate afforded to the subprime lender by the Court below and the 5% statutory interest rate currently paid on federal income tax underpayments under 26 U.S.C. § 6621.

throughout the statute creates "patent absurdity" within a statute that under Petitioners' view would easily be read as a cohesive whole. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 563 (1994).

D. Petitioner's Present Value Interpretation is Consistent With Important Policies Underlying Chapter 13

Although policy considerations may be irrelevant in a case where the language of the statute is clear, *Patterson v. Shumate*, 504 U.S. 753 (1992), the majority panel below makes certain presumptions regarding "Congressional intent." Petitioners will therefore briefly address the intent actually expressed by Congress.

The legislature has expressed a clear intent to encourage filing of Chapter 13 reorganizations over Chapter 7 liquidations. H.R. Rep. No. 95-595, 95th Cong. 2d Sess. 118,129, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6080, 6090.[19] Chapter 13 envisioned a new arrangement amongst the debtor and his or her creditors — not a mere continuation of a pre-petition agreement. The drafters of the Code clearly intended to strengthen the hand of debtors in dealing with their secured creditors. According to the House Report, "one of the most significant changes from current law ... is the treatment of secured creditors and secured claims," to give the secured creditor the "value" of its property rights. Margaret Howard, "A Symposium on Bankruptcy Reform: An Agenda for the Next Century: Essay: Secured Claims in Bankruptcy: An Essay on Missing the Point," 23 Cap. U.L.

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[19] During 2002, 1,103,029 non-business Chapter 7 filings were reported nationwide, in comparison to 454,293 non-business Chapter 13 filings during the same period. Annual U.S. Non-Business Bankruptcy Filings by Chapter, http:www.abiworld.org/stats/nonbuschapter.html.

Rev. 313, 315 (1994), *citing* H.R. Rep. No. 595, 95th Cong., 1st Sess. 180 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6141. The drafters of the Code clearly intended to strengthen the hand of debtors in dealing with their secured creditors. The majority panel's imposition of the 21% pre-petition contract rate of interest is "demonstrably at odds with the intentions of the drafters." *BFP*, *supra*, 511 U.S. at 563.

Another goal of Chapter 13 is efficiency of administration. The emergence of fact-specific inquiries (and the need for evidentiary hearings to resolve otherwise routine present value calculations) can overwhelm the bankruptcy courts' limited judicial resources and substantially increase the costs of administration of the typical Chapter 13 case.[20] The loan market currently passes the costs associated with inefficient and unpredictable cramdown procedures onto the borrower in the form of higher interest rates.

Equality of distribution amongst creditors is a fundamental policy of bankruptcy law. Underlying the legislative scheme of Chapter 13 is the premise that unsecured creditors receive greater repayment in Chapter 13 than in Chapter 7, and that the

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[20] The costs of collection in Chapter 13 consume a high percentage of debtor plan payments. The debtor must pay a filing fee of $185.00, and an attorney's fee typically ranging from $1,000.00 - $2,000.00. David A. Lander, "Essay, A Snapshot of Two Systems That Are Trying to Help People in Financial Trouble," 7 Am. Bankr. Inst. L. Rev. 161, 172 (1998). For services including collection and disbursement of plan payments, the trustee is entitled to compensation up to 10% of all payments made under the plan, subject to a statutory cap. 28 U.S.C. § 586(e). Chapter 13 costs paid by debtors are in effect financed by unsecured creditors. Another study found that routine non-business Chapter 13 cases require on average nearly three times more court time per case than non-business Chapter 7 cases. Gordon Bermant et. al., "A Day in the Life: The Federal Judicial Center's 1988 – 1989 Bankruptcy Court Time Study," 65 Am. Bankr. L. J. 491, 492-93 (1989).

higher costs of Chapter 13 relative to Chapter 7 are warranted by the greater repayment of unsecured creditors. However, almost no empirical evidence validates this assumption. Norberg, *supra*, 68 Am. Bankr. Inst. L. Rev. at 417-18. The Norberg study concluded that unsecured creditors collect very little of their claims in Chapter 13. Norberg described the vast disparity of treatment of unsecured and secured claimants under Chapter 13 as follows:

> In sharp contrast to unsecured creditors, secured creditors fared handsomely in chapter 13....Approximately 90% of all chapter 13 payments (excluding attorneys' fees) went to secured creditors. While only about one-third of the debtors obtained a discharge, secured creditors collected nearly two-thirds of their claims....

Id. at 418.

Norberg concluded that the future promises even lower distributions to general unsecured creditors in Chapter 13:

> ....In practice, the Fifth Circuit's ruling [in *Smithwick*] is shifting far more dollars from unsecured to secured creditors' pockets than the *Rash* decision regarding valuation.

Id. at 438-39 (*also citing GMAC v. Jones*, and *Memphis Bank*, *supra*, et. al.).

Despite Congress' efforts to redistribute the balance of power from secured claimants to general unsecured claimants and in favor of a debtor's successful reorganization, the Bankruptcy Reform Act of 1978 has yet to fulfill these most fundamental objectives.

E. Petitioners' Present Value Interpretation is Consistent With This Court's Prior Cases

The reasoning of several key decisions of this Court is contrary to the conclusion of the panel majority.

Pursuant to 11 U.S.C. § 1322(b)(2), Chapter 13 debtors can modify the rights of secured creditors such as SCS. According to this Court in *Nobelman v. American Savings Bank*, 508 U.S. 324, 329 (1993), the "rights" implicated by § 1322(b)(2) are *those rights provided by state law*, including the *contractual interest rate*. *Nobelman* established that a creditor's state-law property rights are recognized in bankruptcy *only* in the absence of "controlling federal law."

Because this Court in *Rash, supra,* 520 U.S. 953, recognized the cramdown provision as "controlling federal law," this Court, unlike the majority panel below, rejected the argument that the creditor should be placed in the same economic position that it would have been had it exercised its state-court foreclosure rights.

This Court in *Timbers, supra,* 484 U.S. at 372, determined that a creditor's "interest in property" means its security interest (value of collateral or allowed secured claim) *without* taking into account the creditor's state-law right to immediate possession of the collateral on default or lost opportunity costs resulting from the creditor's inability to liquidate the collateral pending confirmation of a Chapter 11 plan.

Distilled to its barest essence, the "coerced loan" theory adopted by the majority panel is an argument for compensating the creditor for "lost opportunity costs" which result when the creditor is denied the ability to immediately liquidate the collateral and reinvest the proceeds. Under the language of the cramdown statute, the creditor is to be compensated *only* for the *fixed amount of the allowed secured claim* (an amount strictly limited to the value of the property securing the debt).

124 Cong. Rec. H. 11,103 (daily ed. Sept. 28, 1978); 124 Cong. Rec. S. 17,420 (daily ed. Oct. 6, 1978). *Timbers* has been read to remove the elements of profit and lost opportunity costs from the present value calculation. Hon. John K. Pearson, "Ending the Judicial Snipe Hunt: The Search for the Cramdown Interest Rate," 4 Am. Bankr. Inst. L. Rev. 35, 52 (1996). *Timbers* recognized the fact "that secured creditors do not bear one kind of reorganization cost hardly means that they bear none of them." *Id.* at 379.

This Court in *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235 (1989), preserved the traditional distinction between pre-petition contract interest and post-petition bankruptcy interest when it established that payment of pendency interest to an oversecured creditor under 11 U.S.C. § 506(b) is *noncontractual.* If pendency interest under § 506(b) is *noncontractual*, there is certainly no argument that present value payments following confirmation (which novates the debtor's pre-petition agreements) is *contractual.*

This Court in the pre-Code case of *Vanston Bondholders, supra*, 329 U.S. at 163-64, noted that the "touchstone" of every decision on the allowance of interest in bankruptcy reorganizations has been a balance of the equities between creditor and creditor or between creditors and the debtor, thus forewarning of the gross equities which result when a particular class of creditors -- in the present case the subprime lender -- is arbitrarily singled out for preferred distribution of the debtor's limited resources.

Although this Court has never considered the appropriate discount rate in the context of the Bankruptcy Code, this Court has previously examined discounting to present value in other contexts. In *Commissioner of Internal Revenue v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 150 (1974), this Court described the economics underlying "discount" to adjust for the difference between the interest prescribed in the

instrument issued and the prevailing *market rate* for money, in much the same way the market rate concept was originally intended by commentators to distinguish "present value" plan interest from contract or pendency interest.

In the context of discounting lost future earnings to present value, this Court in *Jones & Laughlin Steel Corp. v. Pfeifer,* 462 U.S. 523, 537 (1983) concluded that the discount rate should be based on the rate of interest that would be earned on the best and safest investments, and noted that the arithmetic necessary for discounting may be simplified through use of present value tables standard in the financial community. *Id.* at 537. Although these nonbankruptcy cases did not adopt an exclusive federal rule (for discounting awards of future damages to present value), *Chesapeake & Ohio Railway Co. v. Kelly*, 241 U.S. 485 (1916), these cases are important for several reasons. First, this Court in *Pfeifer* concluded that *federal law* applies in determining the method for discounting to present value where the cause of action is rooted in federal statute. *Id.* at 547. Second, this Court applied terms employed by the financial and economic communities to describe the limited function of the present value concept and to establish guidelines as to what factors could be considered and what losses must be excluded from the discounting process. Under a traditional economic analysis, this Court in *Pfeifer* recognized that the market interest rate consists of two components: a) the real interest rate which is essentially constant over time (i.e., between 1 – 3%) and b) an estimate of anticipated inflation. *Id.* at 542.[21]

[21] *See* David R. Herwitz and Matthew J. Barrett, Accounting for Lawyers p. 206 (3d ed. 2001) [analysts' projection of real rate of interest between 2–3 % per year]; a survey of economists in Oct. 2002 generated a consensus inflation expectation of 2.3% for 2003. "Economic Trends," Federal Reserve Bank of Cleveland, p. 2 (Nov. 2002), http://www.clev.frb.org./research/Et2002/1102/Trends.pdf.

Perhaps most importantly, commentators who have examined the primary methods of discounting approved by the Supreme Court in this context, have concluded that the alternate models are essentially equivalent in that they yield the same present value when properly applied -- thereby simplifying and standardizing the process of damage assessment, and greatly reducing the variation amongst awards in similar cases.[22] This Court has thus adopted an approach to these cases that adheres to historic economic concepts of discounting and avoids the wild variations and windfalls that result from the demands of special interest groups.

II. FUNDAMENTAL ERRORS OF THE SEVENTH CIRCUIT AND OTHER CIRCUITS ADOPTING COERCED LOAN OR PRESUMPTIVE CONTRACT METHODS

A. Unfounded Presumptions of Legislative Intent

Despite the fact that the majority panel below considered the language of § 1325(a)(5)(B)(ii) to be unambiguous (Pet. App. A at 11a, n.4), the Court oversteps the statute and embarks upon a path of presumptions.

The Seventh Circuit begins with the presumption that § 1325(a)(5)(B)(ii) must place the secured creditor in an economic position equivalent to the position it would have occupied had the debtor-creditor relationship been terminated under § 1325(a)(5)(C). From there, the Seventh Circuit reaches the foregone conclusion that the "creditor is entitled to the rate

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[22] *See, e.g.*, Gary A. Anderson and David L. Roberts, "Economic Theory and the Present Value of Future Lost Earnings: An Integration, Unification, and Simplification of Court Adopted Methodologies," 39 U. Miami L. Rev. 723, 750 (1985) [concluding that the "nominal growth in earnings," "real growth in earnings," and "differential discount rate" models yield the same present values when properly applied].

of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." (Pet. App. A at 11a-12a, 17a-21a).

The Seventh Circuit's analysis is premised upon several assumptions that have been rejected by this Court. For instance, this Court in *Rash*, *supra*, 520 U.S. at 954, made clear that "[s]urrender and retention [of collateral] are not equivalent acts."

In mandating that the element of profit be included in the present value calculation, the majority below actually concluded that there exists a "statutory directive" (Pet. App. A at 19a) that the creditor be placed in the same position that it would have been in had it been permitted to repossess the collateral. In stark contrast, this Court in *Rash* recognized that modification of state-law remedies is in fact a central purpose of the bankruptcy laws:

> ....In allowing Chapter 13 debtors to retain and use collateral over the objection of secured creditors, however, the Bankruptcy Code has reshaped debtor and creditor rights in marked departure from state law....The Code's cram down option displaces a secured creditor's state-law right to obtain immediate foreclosure upon a debtor's default....

520 U.S. at 964.

State laws reflect the policy decisions of each state concerning the proper balance between creditor and debtor rights. *See, e.g. BFP, supra*, 511 U.S. at 540. In adopting the Bankruptcy Code, Congress struck its own balance between the interests of debtors and creditors.[23]

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[23] This Court has noted that "all bankruptcy law...modifies the procedural rights available to creditors to protect and satisfy their liens." *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 206 (1983). "The Bankruptcy Code

As in *Rash*, state law is not "displaced" by modification of the creditor's contractual interest rates, because there simply is no state law regarding the rights of secured creditors in Chapter 13 cramdown. State-law contracts are routinely discarded in bankruptcy.[24]

The Seventh Circuit's "contract presumption" approach to cramdown interest is all the more inexplicable given the fact that the Seventh Circuit had already had occasion to examine the issue almost 20 years earlier in the case of *Matter of Burgess Wholesale Mfg. Opticians, Inc.*, 721 F.2d 1146 (7th Cir. 1983).[25] In *Burgess*, the Seventh Circuit interpreted "value, as of the effective date of the plan" at 11 U.S.C. § 1129(a)(9)(C) as strictly a "time value of money" concept to require that plan payments be discounted to "present value" as of the effective date of the plan. Although the Court in *Burgess* did not define the method for determining "present value," the *Burgess* decision had been cited as Seventh Circuit precedent distinguishing the concepts of statutory "present

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provides secured creditors various rights, ..., and these rights replace the protection afforded by possession." *Id.* at 207.

[24] There are numerous instances in which the Code alters pre-bankruptcy entitlements to advance a specific bankruptcy policy, *see, e.g.*, § 547(b)(trustee avoidance of preferential transfers); § 510(c)(equitable subordination of claims); § 365 (presumption that executory contracts are rejected); unsecured creditors are typically denied their state-law entitlements as a result of the reorganization.

[25] The contrast between the Seventh Circuit's analyses in *Burgess* and *Till* is striking. Since the statutory language remained unchanged between 1983 when *Burgess* was decided and the 2002 *Till* decision, the Seventh Circuit's dramatic shift in interpretation may best be explained by extra-judicial factors that accompanied the advent of the "coerced-loan" theory with the influx of subprime lending between the early 1980s and 1990s.

value" and "contractual interest." The Seventh Circuit in *Till* made no attempt to reconcile — nor to even acknowledge — its dramatic shift from the statutory present value concept in *Burgess* to the state law contractual interest concept in *Till*.

B. Contract Presumption Rule is Matter for Congress-- Not the Courts

Petitioners contend that those Circuits which have created a "rebuttable presumption" in favor of the contract rate of interest for discounting of deferred payments to present value in all Chapter 13 cramdowns have undertaken judicial legislation contrary to this Court's admonitions.

In overturning the Seventh Circuit's creation of a "rebuttable presumption" in favor of the foreclosure sale price in the case of *In re Bundles*, 856 F.2d 815 (7th Cir. 1988)(abrogated by *BFP*, *supra*, 511 U.S. 531), this Court in *BFP* noted that § 548(a)(2) goes out of its way to avoid use of the standard term "fair market value" which appears elsewhere in the Code.[26] This Court concluded that the problem with adopting a fixed standard for "reasonably equivalent value" is that such judgments represent "policy determinations that the Bankruptcy Code gives us no apparent authority to make." 511 U.S. at 536-40. *Accord*, *United States v. Noland*, 116 S.Ct. 1524, 1526-28 (1996)[judicial rules may not be established at a level of generality more appropriate for legislative

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[26] This Court in *BFP*, *supra*, noted that the fact that "Congress acts intentionally and purposely when it includes particular language in one section of a statute and omits it in another," is even stronger when the omission entails the replacement of standard legal terminology (in that case, "fair market value" and in this case "contract") with a "neologism" (in that case, "reasonably equivalent value" and in this case, "value, as of the effective date of the plan"). 511 U.S. at 537.

enactment]. Where Congress has intended to create a presumption, it has not hesitated to do so in the statute itself.[27]

The practical confusion resulting from the Court of Appeals' creation of presumptions by judicial fiat has not gone unnoticed. As one commentator described the dilemma created by the Third Circuit's presumption of contract interest in *GMAC v. Jones* (which the Seventh Circuit adopted verbatim):

> Whether the 'rebuttable presumption' creates a burden of persuasion or just an obligation to introduce evidence is unclear. So is the identity of the party who bears the burden because the court spoke not only of the failure of the creditor to 'come forward with persuasive evidence' but also of a need sometimes to 'require the debtor to come forward with some evidence' about whether or not the contract rate is a good measure of the rate the creditor does or would charge currently for similar loans. The court admitted that it was inventing this by fiat as a rule of practice to aid and speed administration, and admitted that an old contract rate is a past matter, likely to be wrong often by a large amount.

Patrick Halligan, "Cramdown Interest, Contract Damages, and Classical Economic Theory," 11 Am. Bankr. Inst. L. Rev. 131, 150 (2003), *citing GMAC v. Jones*, *supra*, 999 F.2d at 70-71.

A review of reported bankruptcy court cases shows that the problems created by a court's insertion of "rebuttable presumptions" into the cramdown statute are far from

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[27] Thus, 11 U.S.C. § 707(b) provides that "there shall be a "presumption" in favor of granting the relief requested by the debtor (Chapter 7 relief over objection based on "substantial abuse"); 11 U.S.C. § 523(a)(2)(C) provides that certain debts are "presumed" to be nondischargeable.

academic. The case of *In re Richard*, 241 B.R. 403 (Bankr. E.D. Tx. 1999) expresses serious concerns that can now be heard in bankruptcy courts across the country in Circuits that have adopted the coerced loan or presumptive contract methods. The court in *Richard* concluded that *Smithwick* had established a rebuttable presumption in favor of the contract rate, as well as a creditor-specific evidentiary standard for rebutting the presumption.

Noting the unenviable plight of the Chapter 13 debtor burdened with this "rebuttable presumption" and the fact that Congress has never consented to demands for statutory recognition of the contract rate, the court concluded that:

> .... the dramatic shift in favor of secured creditors which Smithwick imposes may not only be unwarranted, but contrary to the overall rehabilitative intent of Chapter 13....

241 B.R. at 410.

C. Misapplication of the Legislative History

This Court has stated that appeals to legislative history are well taken only to resolve statutory ambiguity. *Toibb v. Radloff*, 501 U.S. 157, 162 (1991). Even in those cases where reference to legislative history has been deemed appropriate, this Court has made clear that legislative history cannot be employed to add words to a statute that are missing from the statute itself. *United States v. Reorganized C F & I Fabricators of Utah, Inc.*, 518 U.S. 213, 221-22 (1996). Nor can the legislative history of a general and unrelated section of the Bankruptcy Code be used to adopt a rule of interpretation for a separate more specialized section of the Code. *Barnhill v. Johnson*, 503 U.S. 393, 401-02 (1992).

The earliest "contract presumption" cases concluded, solely by reference to the legislative history of § 502(b), that "[o]f

course, there is a presumption that the discount rate and the rate set forth in the contract are equivalent." *Matter of Smith*, 4 B.R. 12 (Bankr. E.D. N.Y. 1980); *Accord*, *Matter of Rogers*, 6 B.R. 472, 475 (Bankr. S.D. Ia. 1980).

In the preeminent "coerced loan" case adopted by the majority below, the Court in *GMAC v. Jones*, *supra*, fallaciously *cited only the legislative history of § 502(b)* as so-called "support for the idea that the contract rate is to be accorded ... privileged significance when determining the appropriate interest rate" in the cramdown context. 999 F. 2d at n. 10. *See also*, In re *Smithwick, supra*, 121 F.3d 211.

This attempted use of legislative history of § 502(b) by coerced loan theorists to support a presumptive contract rate of interest under § 1325(a)(5)(B)(ii) is completely unfounded. As one commentator described:

> The legislative history indicates that in addition to disallowing interest not yet due and payable, any pre-paid interest representing an original discounting of the claim (for example, a cash advance of less than the face amount of a note) is also excluded.... HOUSE REPORT, [H.R. Rep. No. 595, 95th Cong., 1st Sess. 119 (1977)] at 352; SENATE REPORT, [S. Rep. No. 989, 95th Cong., 2d Sess. 12 (1978)] at 62....
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> * * * *
>
> This can be conceptualized as discounting the total claim to present value by a factor equal to the contractual rate of interest. In other words, there is an 'irrebuttable presumption that the discounting rate and the contractual interest rate' are the same. HOUSE REPORT, *supra*...at 353; SENATE REPORT, *supra*... at 63.

David Kennedy, "Bankruptcy Reform Act of 1978: Chapter 13 Cramdown of the Secured Creditor," 1981 Wis. L. Rev. 333 at 346, n.74.

Other commentators concur that § 502(b) deals specifically with the process of discounting a pre-petition claim to present value for purposes of accelerating the principal debt as of the petition date, and has absolutely no relevance to the cramdown discount rate under §§ 1129 or 1325. C. Frank Carbiener, "Present Value in Bankruptcy: the Search for an Appropriate Cramdown Discount Rate," 32 S.D. L. Rev. 42 (1987) (citations omitted).

Most significantly, during the legislative process leading to the Bankruptcy Amendment and Federal Judgeship Act of 1984, Congress specifically considered and rejected an amendment requiring the contract rate of interest to be paid under § 1325(a)(5)(B)(ii), despite the urgings of a forceful creditors' lobby. H.R. 1085, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 1169, 98th Cong., 1st Sess. § 19(2)(A)(1983); H.R. 4786, 97th Cong. § 19(2)(A)(1981).

D. Reliance Upon Unsupported and Conflicting Excerpts From Collier Treatise

Much of the confusion that has surrounded the § 1325(a)(5)(B)(ii) present value concept was generated by an editor's comment in the Collier Bankruptcy treatise, where it was submitted in the context of ascertaining present value under 11 U.S.C. § 1129(a)(9)(C), that "deferred payment" of an obligation under a plan is a "coerced loan" for which the creditor must receive a "market rate" of interest corresponding to the rate the creditor would charge to a third party in a like-kind loan. 4 Collier on Bankruptcy, ¶ 1129.03, at 1129-62, 63 (15th ed. 1987).

As described by the court in *In re Computer Optics, Inc.*, 126 B.R. 664, 671 (Bankr. D.N.H. 1991), "without citing any

... authority ..., the Collier treatise took a 'quantum leap' from the present value concept (...time value of money) into a totally different concept of a loan transaction" involving a fact-specific inquiry that has "skewed the analysis ever since."

In harshly criticizing courts' attempts to apply the contract rate for the present value calculation under § 1325(a)(5)(B)(ii) despite the legislature's express rejection of the contract rate, the Collier treatise stated as follows:

> ...contrary to the holdings of a number of courts, it is rarely appropriate to select the rate charged to the debtor in the original transaction as the present value discount rate. Treating the chapter 13 deferral of payments like a new loan transaction, as those courts have done, provides the holder of the allowed secured claim with not only the cost of the funds it would lend but also the costs of the new loan transaction, which would not be incurred, and the profit that would be earned in that transaction...To include them in the present value discount rate would give the holder of an allowed secured claim more than the equivalent of immediate payment of that claim in full.

5 Collier on Bankruptcy ¶ 1325.06, at 1325-37, 38 (15th ed. 1987).[28]

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[28] Compare the factors for which SCS was compensated by the panel majority below, including profit (Pet. App. B at 19a), compensation for depreciation in value of collateral and the creditor's cost of continuing to service the loan (Pet. App. B at 16a). As demonstrated above, the higher the original contract interest rate, the higher the costs saved by the creditor in bankruptcy, Carbiener, *supra*, 32 S.D.L. Rev. at 65.

E. Improper Invocation of *Murel* "Indubitable Equivalent" Doctrine

Another major source of "authority" for advocates of the "coerced loan" theory is the case of *In re Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935), which arose under the Bankruptcy Act of 1898 and introduced the concept of "indubitable equivalence." Misapplication of the *Murel* decision played a most decisive role in the erroneous conclusion ultimately reached by the majority below. The majority panel concluded that its application of the coerced loan approach was mandated by the Seventh Circuit *Koopmans* decision, *supra*, 102 F.3d 874. *Koopmans* construed *Murel* as controlling precedent on the "rate of interest" that a secured creditor is to receive under a Chapter 12 cramdown. 102 F.2d at 874-75 (Pet. App. B at 17a).

The precedential value placed upon *Murel* in the cramdown context was finally dispelled by this Court in *Timbers, supra*, 484 U.S. 365. This Court in *Timbers* made the critical distinction that Judge Hand in *Murel* used the words "indubitable equivalence" not with reference to *"interest"* (as it was interpreted by the Seventh Circuit in *Koopmans* and by the majority panel below), but rather "with specific reference to the *jeopardized principal* of its loan" (emphasis added). *Id.* at 378. As noted by this Court in *Timbers*, the necessity for showing something more ("indubitable equivalence") in *Murel* resulted from the plan's lack of proper provision for payment of the principal — *not from use of an insufficient present value discount rate. Id.* at 378. The central premise upon which the panel majority's decision was based -- that discounting to present value requires the undersecured creditor to receive the "indubitable equivalent"[29] of its nonbankruptcy entitlement and

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[29] The "indubitable equivalence" standard was never codified under Chapter 13, and is thus inapplicable to Chapter 13 cramdown. *Cf., Matter*

be placed in as good a position as it would have been had it been entitled to foreclose its collateral and reinvest the proceeds -- derives from a misapplication of the pre-Code *Murel* doctrine. The fact that the cramdown statute did not even exist at the time of the *Murel* decision shows the cramdown statute simply played no part in the outcome.

III. *KIDD* REJECTS CONTRACT RATE IN SIXTH CIRCUIT WHERE COERCED LOAN THEORY ORIGINATED

The most recent Circuit decision issued by the Sixth Circuit in the case of *In re Kidd*, 315 F.3d 671 (6th Cir. 2003) (Pet. App. H at 82a), raises new questions regarding the continued validity of the "coerced loan" or "contract presumption" methods. The *Kidd* case best demonstrates how one Circuit long-saddled with the "coerced loan" theory devised a not-so-discreet method around it.

A. Sixth Circuit in *Kidd* Clarifies That "Market Rate" Concept Was Never Intended to Require Fact-Specific Inquiry Nor Contract Rate of Interest in Cramdown Context

Memphis Bank & Trust Co. v. Whitman, 692 F.2d 427 (6th Cir. 1982) was the first Circuit Court opinion addressing the methodology for determining the cramdown interest rate under 11 U.S.C. § 1325(a)(5)(B)(ii). According to the Court in *Memphis Bank*, the creditor under the cramdown statute makes a new or "coerced loan" to the debtor in the amount of the current value of the collateral, and the most appropriate interest

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of James Wilson Associates, 965 F.2d 160, 172 (7th Cir. 1992) (in determining whether interest received by creditor under § 1129(b)(2)(A)(iii) was indubitable equivalent of oversecured creditor's lien, Seventh Circuit upheld bankruptcy court's imposition of seven-year Treasury bill rate plus 2.5%.

rate is therefore the current market rate for similar loans at the time the new loan is made.

The decision of the Sixth Circuit in *Kidd* required interpretation of what the Court considered the "controlling case" of *Memphis Bank* (Pet. App. H at 83a). The debtors' contract for purchase of a used vehicle in *Kidd* provided for payment of interest at the rate of 20.95% (App. H at 85a). Creditor Household Automotive Finance Corporation submitted evidence of its status as a "subprime" lender, and testimony that the debtors would not qualify for an interest rate of less than the 20.95% contract rate. The bankruptcy court instead accepted (as evidence of "market rate") a weighted average rate of interest of 9.3% for all car loans (both new and used vehicles for all tiers of borrowers) (Pet. App. H at 86a), and fixed the rate at 10.3%, as a result of a recent rise in interest rates (Pet. App. H at 87a). In upholding the bankruptcy court's determination, the Court of Appeals issued a clear directive for courts in the Sixth Circuit to return to the historic present value concept when it concluded that the proper rate of interest to be applied in a Chapter 13 cramdown is:

> ...the current conventional market rate used for similar loans in the region, and not necessarily the contract rate. Such a determination does *not* entail an analysis of any particular debtor's credit rating but rather involves a *more objective determination of the value of money over time so as to compensate a creditor according to the present value of its secured claim.*

(Pet. App. H at 96a) (emphasis added).

The Court of Appeals in *Kidd* firmly rejected the fixing of a rate based upon a creditor-debtor specific inquiry involving the lender's status as a "subprime" lender:

> In fact, adoption of such a rate is tantamount to endorsement of the automatic application of a contract

rate of interest, a principle clearly at odds with the clear language of *Memphis Bank & Trust.*

(Pet. App. H at 92a-93a).

The court in *Kidd* thus stripped the "coerced loan" theory of its most basic precepts.

B. *Kidd* Decision Calls Into Question Continued Viability of Numerous Circuit Decisions Which Have Misconstrued Sixth Circuit Precedent

Because *Memphis Bank* was the first Circuit decision to adopt a "coerced loan" approach, most, if not all, subsequent Circuit decisions adopting a "coerced loan" approach can be traced back to the *Memphis Bank* decision -- and to what has now been exposed by the Sixth Circuit as an erroneous construction of that and subsequent Sixth Circuit cases.

The majority panel in *Till* patterned its decision after the Third Circuit decision in *GMAC v. Jones, supra*, 999 F.2d 63. *Jones*, in turn, adopted *Memphis Bank* as the pivotal case in which the "Sixth Circuit ... stated tersely ... the basic idea of the 'coerced loan' theory." *Id.* at 67-68. The Sixth Circuit's narrow interpretation of the *Memphis Bank* decision in *Kidd* to preclude a presumption in favor of the contract rate lies in sharp contrast to the Third Circuit's expansive interpretation in *GMAC v. Jones,* where the Court of Appeals adopted the contract rate presumption by erroneously interpreting *Memphis Bank* to require that present value be determined from facts specific to the creditor. *Id., citing Memphis Bank, supra*, 692 F.2d at 429.

The effect of misapplication of the decades-old *Memphis Bank* case has been far-reaching. Virtually all courts adopting a "coerced loan" approach prior to *Kidd* interpreted *Memphis Bank* and its progeny to require a loan-specific inquiry with focuses upon the creditor's return on investment. See, e.g.,

Koopmans v. Farm Credit Services of Mid-America, ACA, 196 B.R. 425, 427-28 (N.D. Ind. 1996), *aff'd*, 102 F.3d 874 (7th Cir. 1996), *GMAC v. Jones, supra,* 999 F.2d at 67-70; *United Carolina Bank v. Hall, supra*, 993 F.2d at 1130-31; *In re Fowler, supra*, 903 F.2d at 698; *In re Hardzog, supra*, 901 F.2d at 860, *United States v. Arnold, supra*, 878 F.2d at 930; *Southern States Motor Inns, supra,* 709 F.2d at 651-652, *cert. denied*, 465 U.S. 1022 (1984).

Those Circuits (like the majority below) adopting a presumption in favor of the contract rate of interest have carried this misconstruction to an extreme. Thus, the Fifth Circuit in *Matter of Smithwick, supra*, 121 F.3d at 213-14, cited language from *Memphis Bank* and relied upon *United Carolina Bank v. Hall, Hardzog,* and *GMAC v. Jones* in adopting the Third Circuit's "coerced loan" approach of a rebuttable presumption in favor of the contract rate.

Although the Court of Appeals in *Kidd* thus went a long way in attempting to limit the damage that has occurred through improper extension of the "coerced loan" theory, the Court could not go far enough as a result of the "precedential deference" it was constrained to accord *Memphis Bank* and its progeny (Pet. App.H at 96a).[30]

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[30] The Court of Appeals in *Kidd* fails to address the fact that the conventional bank loan (which served as the basis for the rate adopted by the Court) included the costs of a new loan transaction, profit and other inappropriate charges. Nor does the Court address the effect of this Court's intervening decisions in the *Timbers* and *Rash* cases. The fact that *Kidd* purports to adhere to a "coerced loan" market rate analysis while rejecting the 20.95% subprime lender's contract rate illustrates the complete arbitrariness and lack of uniformity of the "coerced loan" approach.

IV. FORMULA METHOD AS MEANS FOR RETURN TO HISTORIC PRESENT VALUE CONCEPT

A. Presumed Contract and Coerced Loan Methods Impermissible As Matter of Law

The precise rate of interest to which a creditor is entitled to preserve the present value of its claim under § 1325(a)(5)(B)(ii) is a question of fact to be determined by the bankruptcy court reviewable for clear error, whereas the question of statutory interpretation, including the factors that the trial court is permitted to consider and the components for which the creditor may be compensated, are legal issues subject to *de novo* review, (Pet. App. A at 6a), and properly before this Court for establishment of national guidelines.

It has been suggested that use of significantly different discount rates by experts in the same or similar cases reflect a fundamental misunderstanding of the discounting process. W. Cris Lewis, "The Role of the Discount and Reinvestment Rate in Calculating Future Economic Loss," 34 Fed'n Ins. Couns. Q. 223 (1984). Petitioners contend that, in order to restore a level of uniformity appropriate to a national system of bankruptcy laws, courts must return to the historic concept of discounting to present value, which does not rely upon fact-specific characteristics of the creditor or debtor. With the adjustments essential to discounting under Chapter 13, the appropriate interest rate should fall within a limited range regardless of the identity of the debtor or creditor, the location court in which the determination is made, or the specific nomenclature employed.

Petitioners contend that the Seventh Circuit's adoption of the "coerced loan" or "presumed contract" rate as the present value discount factor constitutes reversible error, as a result of the majority panel's misapprehension of the limited purpose of

the discounting process and resulting compensation of the creditor for factors inappropriate to the discounting process.

B. Calculation of Present Value for Purposes of Section 1325(a)(5)(B)(ii) Must Begin With Risk-Free Rate of Interest

As demonstrated above, in the economic and financial communities, the "discount rate" is universally understood to consist of two components: 1) a riskless rate to account for the time value of money and 2) an adjustment to account for risk. Richard A. Brealey and Steward C. Myers, Principles of Corporate Finance 244 (6th ed. 2000). The formula method is thus the most effective means to an end in this process.

The discount rates applied by the courts have been divided into various classifications, including: 1) the rate on government securities; 2) the federal civil judgment rate set by 28 U.S.C. § 1961; 3) a rate arrived at by averaging or blending; 4) the contract rate; 5) the current market rate for similar loans ("coerced loan" method); 6) the I.R.S. rate set by 26 U.S.C. § 6621; 7) the rate the creditor must pay to replace the funds ("cost of funds" approach); and 8) the prime rate.[31]

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[31] The bankruptcy court in *Till* approved a prime-plus (1.5 risk factor) formula consistent with the approach adopted by the court in the case of *In re Carson*, 227 B.R. 719 (Bankr. S.D. In. 1998). Use of the prime rate in addition to a risk factor has been criticized as overcompensating the creditor. The Court in *In re Fisher*, 29 B.R. 542, 548 (Bankr. D. Ka. 1983), concluded that "prime" is really a form of contract rate for low-risk customers, and that elements of profit and administration costs are included. The plan payout on the SCS secured claim occurred over an approximate one-year period of August 2000 – June 2001. The prime rate on the petition date was 8%; the comparable Treasury bill rate for bills of one-year maturity in 1999 was approx. 4.78%. Federal Reserve System, www.federalreserve.gov/releases. Petitioners contend that the bankruptcy court's use of prime plus 1.5 risk factor exceeded the minimal requirements

Carbiener, *supra*, 32 S.D. L. Rev. 42, examines several of the most common rates. According to Carbiener, all market-sensitive rates which reflect the "time value of money" are 1) responsive to economic conditions existing when the rate is set and 2) easy to calculate. *Id.* at 58. Carbiener assesses the characteristics of each rate for adaptability to the bankruptcy cramdown setting, including adjustments for the duration of the payout period and plan payment terms.[32] *Id.* at 64.

Using a process of elimination, Carbiener concludes that, of the above rates that are market responsive and easy to calculate, only the rates based on government securities do not contain a premium for profit. Although Carbiener considers rates based on government securities to provide the most straightforward approach to an appropriate discount rate, the Carbiener analysis demonstrates that the same result could have been reached by more than one method properly applied. *Id.* at 60.[33] Thus, although certain rates may serve as more

for confirmation, given the elements of profit and costs included in the prime rate, the short payout period of the SCS allowed secured claim, and the creditor's lack of showing of any special risk.

[32] Carbiener points out that most bankruptcy courts have not factored into the present value equation the duration of the payout period or the fact that the typical Chapter 13 involves periodic principal payments plus interest. In contrast, the terms of a government security require periodic payment of interest only, with the entire principal due at the end; the difference is significant because under a plan, the creditor has the use of an increasing portion of its principal claim beginning with the first plan payment, whereas the purchaser of a security is deprived of the use of its money for the entire loan term. *Id.* at 64-65.

[33] Judge Rovner, in her dissent below, recommends a formulaic approach that employs as a base an easily referenced rate like the rate of U.S. Treasury instruments or prime rate, and allows for modest enhancement to the base to account for the risk of nonpayment, *citing Valenti & Doud*,

effective base rates because they require fewer adjustments, these analyses demonstrate that the key to any formulaic approach to Chapter 13 discounting is the elimination of improper elements of creditor compensation.

C. The Diminishing Risk Factor

A decade before this Court's issuance of the *Rash* decision, Carbiener recognized that the risk associated with deferred payments under a Chapter 13 should not be overstated.

A finding of feasibility under 11 U.S.C. § 1325(a)(6), for instance, fixes the court's endorsement that, despite the bankruptcy filing, the debtor is creditworthy for reorganization purposes. *See, e.g., In re Ridgewood Apts. of DeKalb County, Ltd.*, 183 B.R. 784, 792 (Bankr. S.D. Oh. 1995) ["If a plan of reorganization is feasible, qualification of the 'borrower' is established"].

Other nonbankruptcy market-risk factors are similarly eliminated under Chapter 13. Any risk that the debtor has overextended himself by entering into undisclosed obligations is eliminated as a result of extensive disclosure requirements. Most of the costs of administration of a "loan" are handled by the Chapter 13 trustee under § 1325(a)(5)(B)(ii), and the *debtor* — not the creditor — must pay the trustee an additional fee based on a percent of the funds the trustee distributes. The trustee becomes the "collecting agent" for the creditor, but with statutory and court backing — and thus with powers far exceeding the average nonbankruptcy collecting agent. The creditor's costs are thus greatly reduced by the presence of the trustee. *Fisher, supra*, 29 B.R. at 545. The Court in *In re Carson, supra*, 227 B.R. at 723, agreed that the risk premium

supra, and Carbiener at 63-65. The court in *Carson, supra*, 227 B.R. at 723, reasons that, since, with appropriate adjustments, the final interest rate will be the same whether the court starts with the prime rate or the T-bill rate, the choice of nomenclature is irrelevant.

should be minimal in Chapter 13. The creditor's primary protection against risk derives from the creditor's right to seek adequate protection under 11 U.S.C. § 361 at the outset of the case, from its right to retain its lien, from payment by wage assignment orders which substantially reduce the risk of non-payment, from the debtor's restructure of unsecured debt, and from the creditor's right to seek dismissal of the case in the event of a material default which would restore the creditor's pre-bankruptcy remedies. The court further recognized that, in consumer transactions in which APRs are high, the primary factors determining these rates do not relate to risk especially where the debt is secured, but instead to high costs of marketing, high transaction fees, and consumers' failure to effectively shop for lower rates due to various imperfections in the market.

The Court in *Valenti*, *supra*, 105 F.3d 55, considered the pre-*Rash* norm for risk rates throughout the country to range from 1 to 3%. Carbiener concluded that because cases using the government securities approach fail to recognize the cost premium included in government rates, a maximum risk premium of 1% should be adequate unless a creditor can prove that the risk of loss (as opposed to the risk of default) requires a greater premium. *Id.*at 62-63.

(Rash Inclusion of Cramdown Risk in "Value" Component of Present Value Equation)

It has been said that "questions about cramdown interest rates and risk adjustments thereto really are asset valuation questions..." Halligan, *supra*, 11 Am. Bankr. Inst. L. Rev. at 175. The higher the interest rate, the less principal required to produce a given "present value." Irving Fisher, in his classical treatise, The Theory of Interest, *supra*, at 37, stated what he described as the then "seldom ... recognized" fact that any increased burden to the debtor in the principal may be "offset by a reduction in the rate of interest." In present value

analysis, the higher the value assigned to the collateral, the lower the discount factor necessary to preserve the value of the "allowed secured claim." From economic and accounting perspectives, it has been suggested that a creditor concerned with a risk of subsequent default should seek a higher principal (value) and lower interest rate if possible. Chaim J. Fortang & Thomas Moers Mayer, "Valuation in Bankruptcy," 32 U.C.L.A. L. Rev. 1061, 1115 (1985).

This is precisely the choice made by the creditor in *Rash*, *supra*, when it argued for a replacement rather than foreclosure valuation standard for Chapter 13 cramdown. In its merits brief before this Court, Associates Commercial Corporation, at the time an 80-% owned subsidiary of Ford Motor Corporation, justified use of the proposed higher valuation standard as follows:

> ...To be sure, the secured creditor is afforded somewhat greater protection [by replacement value],[34] but that simply reflects the greater risk that the secured creditor assumes by not being able to repossess the collateral. That certainly is a fair exchange for having a plan crammed down over the creditor's objection.[35]

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[34] In August 2002, Ford Motor Credit reported that "...used-vehicle prices are off. The average auction price of an off-lease Taurus was $10,750 in Oct. 2000. It was $8,650 in March [2002]. Other models fared no better." This suggests a widening of the gap between the *Rash* replacement value that the debtor must pay to retain a vehicle and the amount the creditor would receive had the debtor surrendered the vehicle. "Ford Credit Refocuses to Recover From Losses," auto_ford_credit_refocuses.htm.

[35] The debate at that time may best be expressed by Justice Steven's dissent in *Rash*:

> "The Court states that 'surrender and retention are not equivalent acts' from the creditor's perspective because he does not receive

Associates Commercial Corporation v. Rash, Petitioner's Merits Brief filed February 28, 1997, Case No. 96-454.

This Court in *Rash* concurred with the creditor that **"[a]djustments in the interest rate do not fully offset"** the **risks of debtor default and property deteriorat(ion)**, incurred by the creditor when the debtor retains the collateral, whereas the **replacement-value standard accurately gauges the creditor's exposure to these "double risks"** occasioned by the debtor's continued use of the property. 520 U.S. at 962-63 (emphasis added).

In her dissent below, Judge Rovner concluded that by requiring the debtor to pay the creditor the (higher) replacement value of the vehicle, "the Supreme Court has already ensured that the creditor will be afforded significant compensation for the risk of non-payment." (Pet. App. B at 30a). It is thus significant that, with the exception of *Till*, *Smithwick*, and *Kidd*, all Circuit decisions adopting the

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the property and is exposed to the risk of default and deterioration.... I disagree. That the creditor does not receive the property is irrelevant because, as § 1325(a)(5)(B)(ii) directs, he receives the present value of his security interest. Present value includes both the underlying value and the time-value of that interest. The time-value component similarly vitiates the risk concern. Higher risk uses of money must pay a higher premium to offset the same opportunity cost. In this case, for instance, the creditor was receiving nine percent interest, see In re Rash, 90 F.3d 1036, 1039 (CA5 1996) (en banc), well over the prevailing rate for an essentially risk-free loan, such as a United States Treasury Bond. Finally, the concern with deterioration is addressed by another provision of the Code, 11 U.S.C. § 361, which authorizes the creditor to demand 'adequate protection,' including increased payments, to offset an derogation of his security interest during a cram down.

520 U.S. at 966.

"coerced loan" or "presumed contract" rate approach pre-date the *Rash* decision.

So decisive was the *Rash* decision in shifting the risk-component of the present value calculation to the value side of the equation, that courts considering the issue subsequent to *Rash* have significantly limited the risk factor -- or eliminated the risk factor entirely.

The Court in *In re Goodyear*, 218 B.R. 718, 721-22 (Bankr. D. Vt. 1998), noted that *Rash* shifted compensation for the risk of default and property deterioration from the "interest" component to the "valuation" component of the present value equation. Accordingly, the Court determined the interest rate to reflect the present value of the bank's claims to be fixed at the rate on a U.S. Treasury instrument closest in maturity as of the date of plan confirmation, with no additional "default premium."

If the risks of "debtor default" and "property deterioration" are "accurately guaged" by the replacement value as indicated in *Rash*, the creditor is adequately protected and the plan is feasible, additional compensation for these risks in setting the cramdown interest rate vividly illustrates the potential for overcompensation.

CONCLUSION

Petitioners contend that a formula method,[36] with the necessity and amount of risk adjustment to be determined by the bankruptcy court, best satisfies the qualities of the historic present value concept, in that this approach is sensitive to market forces, objective, easily ascertained, and adaptable to the length and payment terms of the Chapter 13 plan. This

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[36] The formula must begin with a risk-free base or have all inappropriate elements of creditor compensation removed.

approach serves an important streamlining function in an area of law that arises frequently in reorganization cases, and reduces the delay and expense of protracted litigation in proceedings that are already too time-consuming and costly. One of the various formula methods also maximizes equality of distribution amongst creditors, increases uniformity in the courts, and complements the rehabilitative purpose of Chapter 13.

For the foregoing reasons, Petitioners respectfully request that the judgment of the Court of Appeals be reversed on grounds that the "coerced loan" and "presumptive contract" methods are inappropriate as a matter of law, and that the cause be remanded for proceedings consistent herewith.

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IN THE

Supreme Court of the United States

LEE M. TILL and AMY M. TILL,

Petitioners,

v.

SCS CREDIT CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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October 24, 2003

QUESTIONS PRESENTED

1. Whether, in cases in which a chapter 13 debtor proposes to pay a secured claim in installments following confirmation of a chapter 13 plan, the rate of interest that the debtor must pay under 11 U.S.C. § 1325(a)(5)(B)(ii) is the prevailing market rate that the particular debtor would pay to a lender on a loan of similar amount, duration, and security?

2. Whether, in the absence of an agreement between the parties or proof of a prevailing market rate, the presumptive rate of interest is the contract rate specified in the debtor's pre-bankruptcy loan agreement with the secured creditor?

RULE 29.6 STATEMENT AND PARTIES TO THE PROCEEDING

Petitioners are chapter 13 debtors Lee M. Till and Amy M. Till. Respondent is secured creditor SCS Credit Corporation. Respondent has no parent company. Respondent is not a publicly traded company, and no publicly traded company owns 10 percent or more of its stock.

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BRIEF FOR RESPONDENT

This matter arises out of the joint chapter 13 bankruptcy case of petitioners Lee M. Till and Amy M. Till (the "Tills" or "Petitioners"). Before the Tills filed for bankruptcy, respondent SCS Credit Corporation ("SCS" or "Respondent") financed their purchase of an automobile. In their chapter 13 plan, the Tills proposed to keep the automobile and pay SCS's secured claim in installments over time. The issue is the proper rate of interest that the Tills are required to pay to SCS under section 1325(a)(5)(B)(ii) of the Bankruptcy Code. 11 U.S.C. § 1325(a)(5)(B)(ii).

STATEMENT

A. The Underlying Retail Installment Transaction

On October 2, 1998, the Tills purchased a used 1990 Chevrolet S-10 truck (the "Chevy") from Instant Auto Finance ("Instant Auto") for $6,395.00, plus fees and taxes of $330.75. JA 21. The Tills made a down payment of $300 toward their purchase and financed the balance of $6,425.75 on credit, executing a Retail Installment Contract ("Installment Contract") in which they agreed to pay this balance over time in 68 bi-weekly installments. *Id.* The installment payments included interest on the financed debt at the rate of 21%. *Id.*

As security for the debt, the Tills granted Instant Auto a purchase money security interest in the Chevy, JA 21; *see* Ind. Code Ann. § 26-1-9.1-103, vesting Instant Auto with the rights of a secured creditor; *see also* Ind. Code Ann. §§ 26-1-9.1-201, 203. Thus, in the event the Tills defaulted under the Installment Contract (e.g., failed to make any of the installment payments when due), Instant Auto had the right to take immediate possession of the Chevy, sell it, and use the proceeds to satisfy the unpaid portion of the Tills' obligation. *Id.*, §§ 26-1-9.1-609, 610, 615. Instant Auto also enjoyed a priority right to its collateral (the Chevy) ahead of the Tills' other creditors. *Id.*, §§ 26-1-9.1-201, 324(a).

After the Tills purchased the Chevy, Instant Auto assigned the Installment Contract to SCS. As a result, SCS acquired all of Instant Auto's rights as a secured creditor in connection with the Chevy and the Tills made their installment payments to SCS.

B. The Tills' Chapter 13 Case and SCS's Secured Claim

On October 25, 1999 — little more than a year after they purchased the Chevy — the Tills filed a joint petition for relief under chapter 13 of the Bankruptcy Code, 11 U.S.C. § 1301 *et seq.*, with the United States Bankruptcy Court for the Southern District of Indiana. By that time, the Tills had missed several payments under the Installment Contract and were in default under the agreement. JA 17 (noting arrearages and other late charges of $994.03). Because of the bankruptcy filing, however, the Tills retained possession of the Chevy and SCS could not exercise its state-law collection rights.

By operation of law, when a debtor files a chapter 13 case, a bankruptcy estate is created consisting of all of the debtor's property, including any automobile that the debtor may own. 11 U.S.C. §§ 103(a), 541(a), 1306(a). Thereafter, the Code authorizes a chapter 13 debtor to remain in possession of all property of the estate. 11 U.S.C. § 1306(b). Thus, when the Tills commenced their bankruptcy case, the Chevy became property of their bankruptcy estate, and the Tills continued to use the vehicle.

A debtor's bankruptcy filing also triggers the "automatic stay," which enjoins debt-collection activity against the debtor or property of the estate during the pendency of the case. 11 U.S.C. § 362(a). The Tills' filing of their bankruptcy case thus prevented SCS from taking action to collect the unpaid balance of their debt. It also prevented SCS from exercising its rights against the Chevy, notwithstanding the Tills' failure to make the agreed payments under the Installment Contract. Instead, SCS acquired a "secured claim" in the Tills' bankruptcy proceeding.

Under the Bankruptcy Code, a debtor's monetary obligations constitute "claims" against the debtor's bankruptcy estate. 11 U.S.C. §§ 101(5), 502(b). Creditors holding pre-petition claims, including secured creditors, are entitled to file a "proof of claim" with the bankruptcy court. 11 U.S.C. §§ 101(10), 501(a), 1305; Fed. R. Bankr. P. 3001, 3002.[1] SCS filed a proof of claim, stating that the Tills owed a debt of $4,894.89 under the Installment Contract as of the date of the commencement of their case. JA 16. The proof of claim stated further that SCS's claim was secured by a lien on the Chevy, and that the Chevy had a value of $4,000. *Id.*, 16-17.

The Bankruptcy Code has special provisions governing the determination and treatment of secured claims. Where, as here, the secured creditor's claim ($4,894.89) exceeds the value ($4,000.00) of the collateral securing the debt, section 506(a) of the Code separates the creditor's claim into two parts. 11 U.S.C. § 506(a). First, the creditor holds a "secured claim" equal to the value of the collateral. *Id.* Second, the creditor holds an unsecured claim for the balance (or "deficiency"). *Id.*; *see Associates Commercial Corp. v. Rash*, 520 U.S. 953, 960 (1997); 4 *Collier on Bankruptcy* ("*Collier*"), ¶ 506.03 at 506-9 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2003) (hereinafter, "*Collier*"). It is settled that, in cases such as this one, in which the debtor proposes to retain the collateral, the relevant standard to use in valuing the collateral is "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller." *Rash*, 520 U.S. at 960.

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1. The Code defines "creditor" as a person holding a claim that arises before the debtor commences a bankruptcy case. 11 U.S.C. § 101(10). The term "pre-petition" refers to claims or events arising or occurring *before* the debtor files a bankruptcy petition. Conversely, the term "post-petition" refers to claims or events arising or occurring *after* the debtor files.

Applying section 506(a), the Bankruptcy Court set the amount of SCS's "secured claim" at $4,000.00 — a sum equal to the value of the Chevy, but significantly less then the total amount of the Tills' debt ($4,894.89). JA 57. For its deficiency, SCS received an unsecured claim in the amount of $894.89.

C. The Tills' Chapter 13 Plan and the Proposed Treatment of SCS's Secured Claim

A chapter 13 debtor is required to file a "plan" proposing the payment of claims (including secured claims), either with the filing of the bankruptcy petition or within fifteen days thereafter. 11 U.S.C. § 1321, 1322; Fed R. Bankr. P. 3015. The Tills filed their plan at the time they commenced their bankruptcy case.

The plan must provide for the submission of all or part of the debtor's future earnings to fund the payment of claims for a period of between three and five years. 11 U.S.C. §§ 1322(a), (d). The Tills proposed to devote $1,089.00 of their monthly income for three years toward the payment of claims, including SCS's secured claim. JA 9.

A chapter 13 plan may designate classes of creditors, and, in general, modify the rights of creditors, including those holding secured claims. 11 U.S.C. §§ 1322(b)(1), (2). Under section 1325(a)(5), however, a plan may not be confirmed unless it satisfies one of three alternative tests regarding the treatment of secured claims. First, the secured creditor may consent to its treatment under the plan. 11 U.S.C. § 1325(a)(5)(A). Second, the debtor may surrender the collateral to the secured party. 11 U.S.C. § 1325(a)(5)(C). Third, the debtor may retain the collateral provided that the creditor retains its lien and the debtor pays the creditor the "value" of its secured claim "as of the effective date of the plan." 11 U.S.C. § 1325(a)(5)(B).

The debtor may satisfy the last requirement (paying the creditor the "value" of its secured claim) in one of two ways. The debtor may pay the secured creditor the full amount of its secured claim in one lump sum upon the effective date of the plan. Alternatively, the debtor may force an extension of the loan on modified terms by paying the secured claim in installments. Paying a claim over time, of course, does not have the same "value" as immediate payment — a dollar to be paid in the future is worth less than a dollar today. Thus, if the debtor elects to pay in installments, it is undisputed that the debtor must pay interest to ensure that the future payment has the same present value as immediate payment.

In their plan, the Tills proposed to retain the Chevy and pay SCS's secured claim in 17 monthly installments, with interest. JA 12.[2] The interest rate that the Tills selected, however, was 9.5% — less than half the 21% rate specified in the Installment Contract. *Id.*

The plan also provided that the automatic stay would remain in effect for the three-year repayment period, thus preventing debt-collection activity for the duration of the plan. JA 13; *see* 11 U.S.C. § 362(c)(2). The plan further provided that, upon completion of the scheduled payments, SCS would be obligated to release its lien on the Chevy "and deliver clear title to the Debtor(s)." JA 13. Thus, even though the entire debt owed to SCS ($4,894.89) would not be paid in full, SCS would be required to relinquish its lien on its collateral upon the debtor's completion of the installments specified under the plan ($4,000.00 in principal plus interest at 9.5%). Under the plan, the unsecured portion of SCS's overall claim ($894.89) was included in the class of general unsecured claims.

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2. Although the plan states the value of SCS's collateral at $4,225.00, the Bankruptcy Court set the value at $4,000.00. JA 57.

D. The Plan's Treatment of Unsecured Claims

A chapter 13 debtor is not required to provide for the full payment of general unsecured claims. Rather, the debtor is merely obligated to devote his or her projected disposable income to the plan for the duration of the repayment period, 11 U.S.C. § 1325(b), and the debtor's payments must provide unsecured creditors with not less than what they would receive in a chapter 7 liquidation, 11 U.S.C. § 1325(a)(4).[3] In addition, the debtor is required to pay these funds to the chapter 13 trustee, rather than to creditors directly. 11 U.S.C. §-1326(c). The role of the chapter 13 trustee is to supervise the debtor's compliance with the chapter 13 process and to act as the debtor's disbursing agent for the payment of claims. 11 U.S.C. §§ 1302, 1326.

Consistent with these requirements, the Tills proposed that their $1,089.00 monthly contribution would be distributed in the following order: first, to pay the trustee's expenses of administering the plan, JA 10; second, to pay a priority tax claim held by the Internal Revenue Service, *id.*; third, to pay secured claims, including SCS's secured claim, *id.*, 10-12; and fourth, to make distributions to general unsecured creditors to the extent of any remaining funds, *id.*, 12. It is undisputed that, after the payment of administrative, priority, and secured claims, the Tills' contributions would not be sufficient to pay general unsecured claims in full.

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3. The major practical difference between chapter 7 and chapter 13 is that, in a chapter 7 case, the debtor is not obligated to contribute any post-petition earnings toward the payment of claims, but generally cannot retain non-exempt property, which is liquidated for the benefit of creditors. *See* 11 U.S.C. §§ 704(1) (prescribing duties of chapter 7 trustee, including liquidation of property of the estate), 522 (exemptions). In a chapter 13 case, the debtor may retain non-exempt assets, but must devote his or her post-petition earnings toward the payment of pre-petition claims. *See* 11 U.S.C. §§ 1302(b)(1) (prescribing duties of chapter 13 trustee and excluding duty of liquidation under section 704(1)), 1322(a)(1), 1325(b)(2).

E. The Confirmation Hearing

Pending the bankruptcy court's confirmation of a plan, the debtor is required within thirty days of filing his or her plan to begin making the payments called for under the plan to be held in escrow by the chapter 13 trustee. 11 U.S.C. § 1326(a). If the court ultimately confirms the plan, these payments are then released to creditors. 11 U.S.C. § 1326(c). As is common in chapter 13 cases, after the Tills filed their plan, the chapter 13 trustee moved to dismiss their case for failure to make initial payments. JA 25. By February 29, 2000, however, the Tills had cured their default, and the trustee withdrew his motion. *Id.*

SCS objected to confirmation of the Tills' initial plan, and the Tills filed an amended plan on January 31, 2000. SCS objected to the amended plan on the sole ground that the 9.5% rate of interest specified in the plan was inadequate under section 1325(a)(5)(B) to provide SCS with the required "value" of its secured claim. JA 22. In response, the Tills sought to "cram down" the plan over SCS's objection, arguing that the rate was adequate.[4] On February 29, 2000, the Bankruptcy Court held a hearing on the Tills' request for confirmation, together with SCS's objection. JA 24.

During the hearing, the Tills explained that they had arrived at the 9.5% rate by taking an unspecified rate of 8% and adding to it an additional 1.5% for risk. JA 37. In support of their proposed rate, the Tills offered the testimony of Steve Russell, an economics professor. JA 40.

At the hearing, Professor Russell reviewed the concepts of a "prime rate" of interest and the basic rate adjustments that

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4. The term "cram down" refers to forcing a creditor to accept the terms of a plan involuntarily. As discussed, a secured creditor in a chapter 13 case may be forced to accept a plan over its objection if the plan satisfies one of the three alternative confirmation requirements of section 1325(a)(5) applicable to secured claims.

lenders typically make to reflect the circumstances of particular borrowers. First, he explained that the "prime rate" is the rate that "banks charge on [unsecured] loans to their most credit-worthy corporate customers." JA 41. He then stated that the prime rate incorporates (a) the general rate of inflation (which he estimated at the time to be approximately 2.5%); plus (b) the expected rate of return on the loan if the funds were loaned on a riskless basis, such as to the federal government on a Treasury bond (which return he estimated at the time to be approximately 3.5%); plus (c) an amount reflecting the transaction costs for the lender associated with the loan; plus (d) the risk that the credit-worthy customer would default. JA 41-42. Second, Professor Russell explained that, for loans to less credit-worthy customers, the rate would be adjusted to take into account (a) the increased risk to the lender of not being paid in full; and (b) the lender's transaction costs associated with the loan, including legal costs and overhead. JA 42.

After reviewing these concepts, Professor Russell opined that a 9.5% rate would be reasonable. JA 43. On cross-examination, however, Professor Russell conceded that he was unfamiliar with how any particular lender would assess the risk profile of a particular borrower. JA 44. He also conceded that he was unfamiliar with the "sub-prime" lending market, the relevant default rates associated with sub-prime car loans, and the relevant collection costs. JA 44-45.[5] Professor Russell further acknowledged that lenders would tend to view sub-prime loans as "singularly risky." JA 44.

5. The term "sub-prime" refers to the credit characteristics of borrowers with weak credit histories. *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency & Office of Thrift Supervision, *Expanded Guidance for Subprime Lending Programs*, 2-3 (January 31, 2001), available at *http://www.fsround.org/PDFs/Subprimeguidance.pdf* (hereinafter, "*Interagency Expanded Guidance*") (defining a sub-prime borrower as one with relatively high default probability as evidenced by a low credit bureau risk score or history of foreclosure, repossession or charge-off).

SCS offered two witnesses: Craig Cook, a sales manager for Instant Auto, and Neil Bird, the general manager of SCS. Mr. Cook explained that the factors that Instant Auto considered in making loans to its customers included current employment, longevity of residence, credit history, references, and the ability to make a down-payment. JA 47. Mr. Cook stated that Instant Auto served the "sub-prime" market — making loans to individuals with "poor credit histories" and who were "risky customers." *Id.* Mr. Cook testified that the Tills' credit history and credit characteristics were typical of other sub-prime borrowers, and that the market rate of interest for such borrowers was 21%. JA 47-48. Mr. Cook testified further that the fact that a borrower files a chapter 13 case is a "negative" credit characteristic. JA 48.

Mr. Bird also testified that the Tills' credit profile was typical of the sub-prime market, and that the prevailing market rate for borrowers such as the Tills was 21%. JA 50, 52. Mr. Bird further explained that SCS and other lenders viewed chapter 13 plans negatively because chapter 13 debtors typically fail to make all the payments required under their plans: "usually we don't get paid the full plan for the vehicle." JA 51. In addition, Mr. Bird explained that the chapter 13 process typically involves delay and that, in some cases, SCS receives no distribution at all under the debtor's plan. *Id.*

F. The Bankruptcy Court's Ruling

On June 27, 2000, the Bankruptcy Court overruled SCS's objection to the plan. (Pet. Cert. App. 40a). The court concluded that the method for calculating an appropriate rate of interest under section 1325(a)(5)(B) is the "prime-plus" formula, determined by taking the prevailing "prime rate" and adding a risk premium, based on the court's assessment of the risks of the debtor's plan. (Pet. Cert. App. 42a-43a). Concluding that 9.5% was an appropriate rate under this approach, the

Bankruptcy Court confirmed the Tills' plan on July 13, 2000. JA 56.[6]

G. The District Court's Reversal

On appeal, the United States District Court for the Southern District of Indiana reversed and remanded. Pet. Cert. App. 34a. Following the Seventh Circuit's prior decision in *Koopmans v. Farm Credit Servs. of Mid-America*, 102 F.3d 874 (7th Cir. 1996), the court concluded that the appropriate rate was a "market rate" determined by the "coerced loan" method, under which the rate is determined by reference to what the secured lender would receive if it collected the proceeds of its collateral and reinvested them in a new loan of similar duration and risk. Pet. Cert. App. 37a-38a. The court concluded that, based on the unrebutted evidence, SCS would have obtained a 21% rate on a similar loan and so found this rate to be controlling. *Id.*, 38a.

H. The Seventh Circuit's Ruling

On further appeal, a divided panel of the Seventh Circuit agreed with the District Court's adoption of the "coerced loan" approach, but remanded with instructions to apply the approach in light of the panel's elaboration of its methodology. Pet. Cert. App. 21a-22a. The court determined that, absent agreement among the parties on an appropriate rate, the secured lender's contract rate should serve as the "presumptive rate." *Id.*, 20a-21a. This rate should control unless the secured creditor presented "'persuasive evidence that its current rate is in excess of the contract rate,'" in which event the current rate would

6. As noted, the 9.5% rate is based on a 1.5% risk premium added to an 8% rate. The United States argues erroneously that the 1.5% premium is "undisputed as a factual finding." US Br. at 26. In truth, there is no evidence to support the 1.5% risk premium. The only evidence is that the Tills are high-risk borrowers and that no lender would lend to them at a rate less than 21%. JA 47-48. The 1.5% figure is simply a number that the Tills offered and the bankruptcy court accepted. It has no basis in "fact."

control. *Id.* (quoting *GMAC v. Jones*, 999 F.2d 63, 70-71 (3d Cir. 1993)). Conversely, the debtor might rebut the presumption in favor of a lower rate if the debtor could demonstrate that "'the creditor's current rate is less than the contract rate.'" *Id.*

In reaching its conclusion, the Seventh Circuit found that the purpose of section 1325(a)(5)(B)(ii) is to place the secured creditor in essentially the same position that it would have occupied had it been able to recover its collateral and reinvest the proceeds in a new loan of similar risk and duration. Pet. Cert. App. 12a. The court observed that, by its terms, section 1325(a)(5)(B)(ii) directs that a secured creditor forced to accept delayed payment must be compensated for the delay in a manner sufficient to preserve the "value" of the creditor's present interest in its collateral. *Id.*

Noting that section 1325(a)(5) provides the debtor with three options for resolving the treatment of a secured claim, the Seventh Circuit reasoned that Congress must have intended all three options to provide roughly equivalent value. Pet. Cert. App. 12a.[7] The court concluded that, in order for the cram-down option to provide the secured creditor with the same value as the other two options (i.e., surrendering the collateral or striking a bargain), the debtor would have to pay interest to the secured creditor at a "market rate." *Id.*, 13a. The court further concluded that the relevant market rate would be what the particular lender would currently receive on a loan of similar duration and risk outside of bankruptcy. *Id.*, 20a.

7. As discussed, the three options are (1) the debtor surrenders the collateral to the secured creditor, 11 U.S.C. § 1325(a)(5)(C); (2) the secured creditor and debtor agree to a consensual rate, 11 U.S.C. § 1325(a)(5)(A); or (3) the debtor "crams down" the secured creditor by forcing the creditor to accept the debtor's retention of the collateral in exchange for installment payments of principal plus interest equal to the "value" of the creditor's secured claim. 11 U.S.C. § 1325(a)(5)(B).

In adopting the contract rate specified in the parties' pre-bankruptcy loan agreement as the presumptive measure of an appropriate market rate, the Seventh Circuit conceded that, in doing so, "we are approximating, not necessarily duplicating precisely, the present value of the collateral to the creditor as [section 1325(a)(5)(B)] requires." Pet. Cert. App. 20a. Nevertheless, the court concluded that "we believe that the old contract rate will yield a rate sufficiently reflective of the value of the collateral at the time of the effectiveness of the plan to serve as a presumptive rate." *Id.*

In conducting its analysis, the Seventh Circuit considered and rejected two competing methods. First, the court considered the "cost of funds" approach, under which a bankruptcy court would set the interest rate based on the creditor's hypothetical cost of borrowing the particular funds that the debtor is obligated to pay under the plan. Pet. Cert. App. 13a. Observing that this approach fails to take account of the risks associated with the debtor's plan, the court rejected it as inadequate to provide the creditor with the "value" of its secured claim. *Id.*, 14a-15a.

Second, the court considered the "formula" approach adopted by the bankruptcy court. Pet. Cert. App. 15a. Rejecting this standard, the court explained that, in enacting section 1325(a)(5), Congress intended to protect secured creditors from several types of risks and costs, including the debtor's risk of default and nonpayment, the continued depreciation of the collateral, and the costs associated with continuing to service the loan. *Id.*, 16a. Observing that the formula approach failed to account adequately for these risks and costs in individual cases, the court concluded that the Code requires a more particularized inquiry. *Id.*, 17a.

SUMMARY OF ARGUMENT

Congress designed chapter 13 to afford insolvent wage-earners the opportunity to devise a plan for the repayment of their debts from future earnings. At the end of the repayment period, the debtor may obtain a discharge of unsatisfied obligations, provided the debtor has substantially completed the payments required under the plan. 11 U.S.C. § 1328. Because the process is strictly voluntary, a debtor may abandon the plan at any time. 11 U.S.C. §§ 1307(a), (b). In fact, most chapter 13 debtors fail to complete their repayment plans. *See Rash*, 520 U.S. at 963 (the "vast majority of [chapter 13] reorganizations fail . . . leaving creditors with only a fraction of the compensation due them") (citation omitted).

The Bankruptcy Code generally allows a chapter 13 debtor to keep his or her assets. If the debtor elects to keep an asset that secures a debt, however, the debtor must pay the creditor the "value" of its secured claim, either immediately, or over time by compelling an extension of the loan. 11 U.S.C. § 1325(a)(5)(B)(ii). If the debtor elects the latter course, the debtor must pay the creditor interest sufficient to ensure that future payments have the same present value as immediate payment. *Id.* The issue in this case is whether the applicable rate of interest is properly a prevailing market rate that takes into account a market assessment of the risks and costs associated with the debtor's promise of delayed payment or some other rate, based on a judicial officer's discretionary assessment of the risks of the debtor's plan, the riskless Treasury-bill rate, or the creditor's cost of borrowing funds.

The essential purpose of interest, no less than the "value" requirement of section 1325(a)(5)(B)(ii), is to compensate a secured creditor for the risks associated with a debtor's payment proposal. It is axiomatic that a risk-laden promise to make payments in the future is far less valuable than the certain right to obtain full payment from collateral today. *See* Richard A.

Brealey & Stewart C. Meyers, *Principles of Corporate Finance 15* (7th ed. 2003) ("*A safe dollar is worth more than a risky one.*"). And a chapter 13 debtor's promise to pay in the future can only be characterized as a very high-risk proposition. A chapter 13 debtor's default is also laden with costs. Although the secured creditor's lien in its (typically depreciating) collateral serves as a partial hedge against ultimate nonpayment, the secured creditor's compensation for the debtor's high risk of default, and the costs associated with any such default, is the interest that the secured creditor is entitled to receive.

An appropriate rate of interest in this context is and ought to be a true market rate — or at least as close to a true market rate as is feasible. This means the rate that the particular debtor would pay to a willing lender in the debtor's geographic area on a loan of similar amount, duration, and security. This is the only reliable way to ensure that the interest rate reflects the true risks of the debtor's proposed future payment stream, and thus, the best way to ensure that the secured creditor receives the full "value" of its secured claim, as the statute requires. Indeed, the very purpose of the lending marketplace is to assess and assign interest rates based on the routine evaluation of such risks.

In most chapter 13 cases, the prevailing market rate will be the same as the rate specified in the parties' pre-petition loan agreement, particularly if the agreement was executed in close proximity to the debtor's bankruptcy filing. Certainly, if the debtor's financial circumstances have not improved, the current rate will not be lower than the old contract rate. For this reason, and as the Seventh Circuit determined, it is appropriate to use the contract rate as the presumptive rate. Either party, however, should be afforded the opportunity to demonstrate that the presumptive rate should not control — e.g., because the market rate available to the debtor is substantially higher or lower than the contract rate. In this case, the unrebutted evidence is that a lender would not lend to the Tills at a rate less than 21% due to

their poor credit history and the high prospect of plan default in chapter 13 cases. JA 47-48. This is also the rate specified in the Installment Contract. Hence, in this case, the contract rate and the market rate are one and the same.

Petitioners and their *amici* contend that a judicial officer is best suited to set the rate through application of a formula using the relatively riskless "prime" lending rate, or the riskless Treasury-bill rate, adjusted marginally (by one, two, or three points) according to the judge's sense of the risk of the debtor's plan. Pet. Br. 49; US Br. 8; NACBA Br. 5. Alternatively, they contend that the relevant rate should be the unadjusted, riskless Treasury bill rate. AARP Br. 16-17. A third approach is based on the creditor's cost of funds. Pet. Cert. App. 13a; P Br. 43; T Br. 24. These propositions are unsound.

In no sense is the formula rate a "market rate." Nor does the formula rate, or the riskless Treasury-bill rate, come close to incorporating the true risks associated with the extremely high rate of default of the typical chapter 13 debtor's repayment plan. A rate that consistently overestimates the strength of the debtor's promise of future payment (and correspondingly underestimates the debtor's likelihood of default, together with the associated costs) cannot be faithful to the statutory requirement that any stream of future payments must have a "value" equal to the creditor's secured claim.

The cost-of-funds approach is similarly defective. The rate that a *creditor* must pay to borrow funds in the marketplace will reflect the strength of *its* credit, not that of the debtor. Obviously, the credit-worthiness of the secured party has nothing to do with the risk of the debtor's plan. Accordingly, the cost-of-funds approach is virtually certain to fail the statutory directive that the stream of payments that the *debtor* must make have a "value" equal to the creditor's secured claim.

It is true, of course, that in some (perhaps many) chapter 13 cases there may be *no* lender willing to lend to the particular debtor at any legal rate, owing to the debtor's poor credit history or other factors. But this hardly supports the application of a formula calling for the use of a relatively risk-free rate, with only marginal, discretionary adjustments. Nor does this possibility support application of a riskless Treasury-bill rate or the cost-of-funds approach, which, again, fail to account for the true risks of the debtor's promise of future payments.

Use of a market rate (rather than the alternatives suggested by Petitioners and their *amici*) finds further support in the Bankruptcy Code's treatment of secured claims generally. Although a chapter 13 debtor may modify the rights of secured creditors, the Code's prevailing philosophy is that the secured party is entitled to the full value of its rights. In the context of section 1325(a)(5)(B), the only interest rate that adheres to this philosophy is the market-rate approach.

The history behind the cram-down option of section 1325(a)(5)(B) further supports use of a market rate. The section traces its origin to early reorganization practice, which embraced long ago the principle of "indubitable equivalence" — i.e., that a secured party is entitled to the full value of its rights, not only with regard to the preservation of its collateral position, but also with regard to the interest it is entitled to receive. Only the market-rate approach is consistent with this history.

Use of a market rate is also the most efficient and economical procedure; comports with applicable bankruptcy policy; is equitable; and is warranted to avoid perverse economic incentives. This Court has instructed that, to fix the amount of a creditor's secured claim in any case in which the debtor proposes to retain use of the collateral, the relevant valuation standard is "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a

willing seller." *Rash*, 520 U.S. at 960. The market rate of interest that the debtor must pay in proposing to pay a secured claim over time encompasses nothing more than an extension of this inquiry: the determination of the rate that a willing borrower in the debtor's trade, business, or situation would pay to finance the purchase of the property from a willing lender. For many of the same reasons that the Court adopted the market-based valuation standard in *Rash*, the Court should adopt the market-based interest-rate standard under section 1325(a)(5)(B). Because the Seventh Circuit adopted such an approach, its judgment should be affirmed.

ARGUMENT

A. The Rate of Interest Payable Under Section 1325(a)(5)(B)(ii) Is a Market Rate That Accounts for the True Risks and Costs Associated with a Chapter 13 Debtor's Typically Uncertain Promise of Future Payment.

1. Section 1325 of the Code Requires the Payment of Interest at a Market Rate.

In crafting the provisions of the Bankruptcy Code, Congress understood that a debtor's mere promise to repay a secured debt — even one written in a chapter 13 plan — is no guarantee of payment. As compensation for the risks and costs associated with the debtor's potential default, Congress expressly required in section 1325(a)(5)(B) that, if the debtor intends to keep the collateral and compel an involuntary extension of the loan on modified terms by paying the secured creditor over time, the debtor's plan must satisfy two criteria. First, the secured creditor must retain its lien on its collateral to assure payment of its secured claim. 11 U.S.C. § 1325(a)(5)(B)(i). Second, the debtor must promise to pay the secured creditor a stream of payments that have a "value, as of the effective date of the plan" that is

"not less than the allowed amount of [the creditor's secured] claim." 11 U.S.C. § 1325(a)(5)(B)(ii); *see Rash*, 520 U.S. at 957 (discussing operation of section 1325(a)(5)(B)).

All agree that, if the debtor proposes to extend the loan by paying the creditor in installments, section 1325(a)(5)(B)(ii) requires the debtor to pay the principal amount of the creditor's secured claim *plus interest*. As a matter of law and logic, the payment of interest is necessary to ensure that the future payments have the same value as immediate payment in full. Because a promise of future payment is inherently more uncertain (and hence less valuable) than full present payment, the payment of interest is necessary to compensate for the difference. *See St. Louis Southwestern R. Co. v. Dickerson*, 470 U.S. 409, 412 (1985) ("It is self-evident that a given sum of money in hand is worth more than the like sum of money payable in the future.") (citations omitted).

As the Court explained in *Rash*, under section 1325(a)(5)(B)(ii), "the debtor is required to provide the creditor with payments, over the life of the plan, that will total the present value of the allowed secured claim, i.e., the present value of the collateral." 520 U.S. at 957. *See also Rake v. Wade*, 508 U.S. 464, 469-70 (1993) ("[Section] 1325(a)(5)(B)(ii) guarantees that property distributed under a plan on account of a claim, including deferred cash payments in satisfaction of the claim, must equal the present dollar value of such claim as of the confirmation date.") (internal citation omitted). As the Court also concluded in *Rake*, section 1325(a)(5)(B)(ii) thus establishes the creditor's entitlement "to interest." *Id.* at 473.[8]

8. The Code's legislative history similarly recognizes that the term "value," as used in the text of section 1325(a)(5)(B) and similar provisions, means "present value" and requires the payment of interest to reflect the economic reality that the value of any promise of future payment must be "discounted" to reflect the fact that future payments (Cont'd)

In common commercial parlance, the concepts of "value," "present value" (or "discounting to present value"), and "interest" have well-recognized meanings and are inter-related. The present value of a future payment turns on how much the future payment must be "discounted" to ascertain its current value. In turn, the amount of the discount reflects nothing more than an imputed rate of interest. *See Dickerson*, 470 U.S. at 412 ("the method of calculating present value should take into account . . . the rate of interest"). For example, if the relevant interest rate is 10%, a promise of $10 a year from now has a present value of $9.09:

> The concept of present value is really quite simple and can be easily illustrated. Assume that A wants to borrow money from B, repayable at a future date. B is willing to make the loan, but feels that, considering the risks involved, he is entitled to a 10 percent annual rate of return. This being the case, how much money will he advance to A on A's note

(Cont'd)
are worth less than the same payments made today. *See* H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6364 (discussing the phrase "value, as of the effective date of the plan" and observing that the phrase "indicates that the promised payment under the plan must be discounted to present value as of the effective date of the plan" and that "[t]he discounting should be based only on the unpaid balance of the amount due under the plan, until that amount, including interest, is paid in full"). *Amicus* AARP argues that a reference in the legislative history to the concept of "value" as including the "time value of money" indicates congressional intent to apply a riskless Treasury-bill rate. AARP Br. 16-18; *see also* US Br. at 11. This is unsound. The concept of the "time-value of money" is simply another reference to present value and does not singularly connote use of a riskless Treasury-bill rate. *See John Downes, Dictionary of Finance and Investment Terms*, 303-04, 436 (1985) (characterizing present value as also "called *time value of money*" and defining "time value of money" as including "present value").

> for $10 payable one year hence? The answer is $9.09, because the $10 paid next year provides interest of $.91, which is 10 percent of a $9.09 loan. Thus, $9.09 is the present value of $10 payable one year hence at a discount rate of 10 percent.

Sumner N. Levine, *Financial Analysts' Handbook I*, 140 (1975).

Put another way, the discounting concept reflects what an investor would pay to "purchase" the particular stream of future payments. In the market, an investor simply would not pay $10 today to receive $10 tomorrow. As another text explains:

> The present value of $400,000 [one] year from now must be less than $400,000. After all, *a dollar today is worth more than a dollar tomorrow*, because the dollar today can be invested to start earning interest immediately. Thus, the present value of a delayed payoff may be found by multiplying the payoff by a discount factor. The rate of return . . . is the reward investors demand for accepting delayed payment. . . . [T]he present value . . . is also [the] market price.

Brealey, *supra* at 14. *See also Protective Committee v. Anderson*, 390 U.S. 414, 442 n.20 (1968) ("Value is the present worth of future anticipated earnings.") (citation omitted); 3 *The New Palgrave Dictionary of Money & Finance*, 172 (Peter Newman et al. eds., 1992) (present value means "the summed discounted value of the stream of revenues which [an] asset generates" as to which "[t]he discount factor will be that determined by the interest rate over the relevant period").

In the context of section 1325(a)(5)(B), the value of the secured claim is known (here $4,000). In addition, the proposed term of repayment is known (here 17 months). The sole issue is establishing a rate of interest necessary to ensure that the

payments (principal plus interest) to be made over 17 months will have a present value of $4,000. Obviously, if the rate of interest is inadequate, then the stream of payments (principal plus interest) will not have a present value of $4,000, but will be worth some lesser amount.[9] Thus, the future payments can have a "value" equal to the secured creditor's claim only if the plan incorporates the correct rate. As the Court explained in *Rake*:

> [A] creditor receives the "present value" of its claim only if the total amount of the deferred payments includes the amount of the underlying claim plus an appropriate amount of interest to compensate the creditor for the decreased value of the claim caused by the delayed payments. This generally involves a determination of an appropriate discount rate and a discounting of the stream of deferred payments back to the present dollar value of the claim at confirmation.

508 U.S. at 472 n.8.

In sum, the concept of interest is integral to the concepts of "value" and "present value." In turn, the concept of "interest" is dependent on the concept of "risk." As Paul Samuelson has written, in theory, an appropriate interest rate in an ideal (riskless) capital market might be set by simple reference to the supply and demand of capital. Paul A. Samuelson, *Economics* 599 (9th ed. 1973). At the same time,

> [t]hat does not mean that I shall make a small loan at this low an interest rate to an applicant whom I do not know and who has lost three jobs in 6 months'

9. For example, if the prevailing interest rate is 10%, offering the secured creditor 1% on a secured claim of $1,000 means that the present value of the payments (principal and interest) will be less than $1,000.

> time: I may have to charge him as much as 20 per cent per annum to compensate me for having to investigate him, dun him for collection, and cover the risk premium from default and costly litigation.

Id. See also Edwin Mansfield, *Economics: Principles, Problems, Decisions* 563 (1974) ("One of the most important determinants of the rate of interest charged a particular borrower is the *riskiness* of the loan. Naturally, if the lender has doubts about his chances of getting his money back, he will charge a higher interest rate than if he is sure of being repaid."); Daniel B. Suits, *Principles of Economics* 495 (1973); Christine Ammer, *Dictionary of Business and Economics* 236 (1984).

Echoing these concepts, the Court has explained, "as respects 'interest,' the usual import of the term is the amount which one has contracted to pay for the use of borrowed money." *Deputy v. Du Pont*, 308 U.S. 488, 497-98 (1940). *See also Bruning v. United States*, 376 U.S. 358, 360 (1964). The Court has recognized further that, in establishing a particular rate, the risks presented by the debtor's circumstances must ordinarily be taken into account:

> It is common knowledge that interest rates vary not only according to the general use value of money but also according to the hazard of particular classes of loans. Delinquent taxpayers as a class are a poor credit risk; tax default, unless an incident of legitimate tax litigation, is, to the eye sensitive to credit indications, a signal of distress. . . . Another variable is the amount necessary to compensate for the trouble of handling the item.

Meilink v. Unemployment Reserves Comm'n of California, 314 U.S. 564, 567 (1942). *See also BFP v. Resolution Trust Corp.*, 511 U.S. 531, 539 (1994) (in considering value, court must take

into account "price-affecting characteristics"); *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 151 (1974) (to determine the "value" of a debt obligation, the court must consider the debtor's "financial condition . . . including both its credit position and its profits prospects").

Moreover, in our economy, interest rates are largely market-driven: "The simplest way to view interest is as a market-determined price charged for the use of money." Lawrence Abbott, *Economics and the Modern World* 640 (1967). Not surprisingly, the riskiest debtors pay the highest rates. As explained in another text:

> Low-risk borrowers such as large corporations pay the prime rate; all other borrowers pay a higher rate. . . . If an individual has a poor credit rating he may not be able to borrow from banks at all, and may have to get a loan from a finance company, whose interest rates range up to 36 percent.

William Albrecht, Jr., *Economics* 597 (1974). *See also* Irving Fisher, *The Theory of Interest* 382 (1930) ("Every lender or borrower knows that the rate of interest varies directly with risk. A bird in the hand is worth two in the bush."); John Lindauer, *Economics* 475-76 (1977); Tomas Sowell, *Basic Economics* 40-41 (2000).

Similarly, the Court has recognized that, in order to fix a true value for a given debt, the relevant standard is typically that of the competitive marketplace, not some artificially determined price: "[I]mplicit in the concept of debt discount is the assumption, and indeed the requirement, that the transaction be subjected to the exigencies of the competitive money market." *National Alfalfa*, 417 U.S. at 151. *See also Koopmans*, 102 F.3d at 876 ("A supplier of capital, no less than a supplier of seeds or combines, is entitled to the market price."). *Cf. Kimball Laundry*

Co. v. United States, 338 U.S. 1, 5 (1949) (the value of property as determined in the market place "has an external validity which makes it a fair measure").

The concepts of "value," "present value," and "interest," thus do not contemplate a rate fixed by a judicial officer based on minimal, discretionary adjustments to the prime rate or Treasury-bill rate. On the contrary, such methodologies are the antithesis of common commercial practice and would virtually ensure that the secured creditor will not receive the "value" of its secured claim, as section 1325(a)(5)(B)(ii) requires. For the same reasons, application of an unmodified Treasury-bill rate, or a rate based on the lender's costs of funds, is similarly inappropriate because they bear no relationship to the actual risk of the debtor's default. *See BFP*, 511 U.S. at 540 ("There is another artificially constructed criterion we might look to instead of 'fair market price.' One might judge there to be such a thing as a 'reasonable' or 'fair' forced sale price. . . . The problem is that such judgments represent policy determinations that the Bankruptcy Code gives us no apparent authority to make."); *Green Tree Fin. Serv. Corp. v. Smithwick (In re Smithwick)*, 121 F.3d 211, 215 (5th Cir. 1997). *Cf. United States v. Cartwright*, 411 U.S. 546, 551 (1973) (for tax purposes, property is generally to be determined by its fair market value, measured as the price a willing buyer would pay, and observing that this standard is a longstanding one).

Moreover, Petitioners and their *amici* fail to recognize that Congress crafted the requirements of section 1325(a)(5)(B)(ii) for the protection of *creditors*, not debtors. *Johnson v. Home State Bank*, 501 U.S. 78, 87-88 (1991). Because the whole purpose of the provision is to ensure that the secured party will receive the full value of its claim, the relevant rate must be one that fully compensates the creditor for the actual risks and costs that it faces. The market-rate approach is the only method designed to fulfill this goal. Accordingly, it is the appropriate method to apply in this context.

2. Chapter 13 Plans Are High-Risk and High-Cost.

SCS does not challenge the legitimacy of the Tills' chapter 13 filing or the Tills' general ability to modify SCS's rights as a secured creditor. SCS does challenge, however, the Tills' attempt to erode the requirements of section 1325(a)(5)(B)(ii) by promoting an interest-rate approach that vastly understates the risks and costs of the chapter 13 procedure. As this Court has recognized, the unfortunate truth is that the risk of default for chapter 13 cases is exceptionally high, rendering chapter 13 plans extremely risky propositions. *Rash*, 520 U.S. at 963 (the "vast majority of [chapter 13] reorganizations fail . . . leaving creditors with only a fraction of the compensation due them") (citation omitted). More than 60% of chapter 13 debtors fail to complete their plans. *See* Jean M. Lown & Barbara R. Rowe, *A Profile of Utah Consumer Bankruptcy Petitioners*, 5 J.L. & Fam. Stud. 113, 119 (2003) (finding that 74% of chapter 13 cases filed in Utah between 1997 and 2001 were dismissed without completion of the debtors' repayment plans); Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 Am. Bankr. L. Rev. 415, 439-40 (1999) (finding that approximately two-thirds of chapter 13 filers do not complete their plans and obtain a discharge); William C. Whitford, *The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy*, 68 Am. Bankr. L.J. 397, 410 (1994) (unpublished national survey of 124 chapter 13 trustees finding district-wide plan completion rates as low as 3%).

Corroborating this experience, the unrebutted testimony in the bankruptcy proceeding was that one reason car-loan providers view chapter 13 plans so negatively is that "usually we don't get paid the full plan for the vehicle." JA 51. Indeed, as one author has written, many chapter 13 debtors fail to make even a single payment. *See* Michael W. Dunagan, *Enforcement of Security Interests in Motor Vehicles in Bankruptcy: The Rash*

to Judgment — A Contrarian View from the Creditor's Perspective, 52 Consumer Fin. L. Q. Rep. 192, 197 (1998) (concluding that the filing of a chapter 13 petition is "the worst thing that can happen to motor vehicle lien holders").

In addition, a failed chapter 13 plan is laden with costs, including the administrative costs associated with monitoring the chapter 13 plan payment process; the costs of delay; and the costs (including attorneys' fees) associated with actual enforcement of the creditor's rights in the event of the debtor's default.

As noted, the automatic stay prevents creditors, including secured creditors, from enforcing their collection rights while the debtor's plan remains in effect. 11 U.S.C. §§ 362(a), 362(c)(2)(C). Thus, when a chapter 13 debtor fails to make scheduled payments under its plan, the secured creditor must return to the bankruptcy court to obtain relief from the stay to enforce its rights. 11 U.S.C. §§ 362(d), 1307(c). At that point, the debtor may (and often will) protest the default, causing further delay and expense. In many instances, the bankruptcy court will give the debtor one or more additional chances to catch up on its payments. At each juncture, the secured creditor is required to shoulder the burden of additional cost — including the cost of paying a filing fee for seeking relief from the bankruptcy court (currently $75.00 for a motion for relief from stay). *See* Fee Schedule for U.S. Bankr. Ct. S.D. Ind., promulgated under 28 U.S.C. § 1930, *available at* http://www.insb.uscourts.gov/. In this case, the fee alone would equal approximately 2% of the collateral value.

Notwithstanding the debtor's default, the debtor will retain possession and use of the collateral until the secured party obtains relief to exercise its rights. In the meantime, the collateral will continue to depreciate, further jeopardizing the creditor's recovery. In addition, defaulting debtors often fail to maintain their vehicles. Thus, even though the secured party may

ultimately succeed in obtaining permission to pursue its rights, the value of the collateral may be further impaired. *See Rash*, 520 U.S. at 963 ("where, as here, collateral depreciates rapidly, the secured creditor may receive far less in a failed reorganization than in a prompt foreclosure") (internal quotation marks and citation omitted).

Because of their financial situation, chapter 13 debtors may also allow their insurance to lapse. If an uninsured debtor is involved in an accident, the secured creditor's position will be further impaired. Indeed, if the vehicle is ruined, the debtor may simply abandon it and seek to have the secured creditor's claim recharacterized as unsecured, based on the diminished value of the collateral. Although the secured party may receive notice from the debtor's insurance company of any lapse, because of the automatic stay, the creditor must seek relief in the bankruptcy court before taking action, causing further expense and delay.

In the vast majority of chapter 13 cases, in which the relevant debts are typically small (e.g., car loans of between $5,000 and $15,000), even seemingly minor administrative costs (e.g., five hours of attorneys' fees) assume large economic significance. Indeed, in a significant number of cases, the cost of a single, contested attempt to obtain relief from the automatic stay following the debtor's failure to make payments under its plan may well exceed the value of the collateral.

Given the high risk that a chapter 13 debtor will eventually fail to make the payments called for under its plan, and given the high costs associated with the debtor's likely default, it cannot be presumed that the risks and costs associated with the typical chapter 13 debtor's promise of future payment will be low. On the contrary, the opposite presumption is warranted. Because the risks and costs are typically extremely high, the appropriate rate of interest is a market rate that fully accounts for these factors. *Cf. Rash*, 520 U.S. at 962 (implying that interest rates might properly be higher in bankruptcy cases).

Petitioners complain that the application of a market approach would yield high interest rates in chapter 13 cases and this could not be what Congress intended when it enacted the Bankruptcy Code in 1978, on the theory that sub-prime lending did not exist at the time. Pet. Br. at 14-18. The practice of charging high interest rates for risky borrowers, however, is not a recent phenomenon. In 1941, this Court observed prevailing interest rates as high as 30%, commenting that these reflected the nature of the loans in question. *See Meilink*, 314 U.S. at 568 (interest rate of 2.5% per month). Moreover, there is simply no evidence that Congress intended to limit the concept of "value" in section 1325(a)(5)(B)(ii) to a particular range of rates.

Petitioners and their *amici* also downplay unreasonably the risks and costs of chapter 13 plans, arguing that a secured creditor enjoys administrative protections that assure payment. These protections, however, are largely illusory, offering little in the way of mitigating the risks and costs of the chapter 13 procedure. For example, pursuant to section 1325(c) of the Code, the court may enter a "wage order," directing that the wages necessary to fund the plan be paid directly from the debtor's employer to the chapter 13 trustee for distribution under the plan. 11 U.S.C. § 1325(c). A wage order is meaningless, however, if the debtor changes jobs; is fired or laid off; or voluntarily abandons a plan. Because these occurrences are commonplace, a wage order is typically no protection at all.

Petitioners and their *amici* suggest further that the risk of default is mitigated because, in order to confirm the plan, the bankruptcy court must determine that the plan is feasible. Pet. Br. 45; US Br. 10; AARP Br. 21-22. This, too, is an illusory protection, as the alleged benefit of a judicial determination of feasibility is belied by the persistently high rate of default in chapter 13 cases.

In addition, Petitioners and their *amici* suggest that a secured creditor's retention of its lien on its collateral is adequate compensation for the risks of the debtor's potential default. Pet. Br. 46; NACBA Br. 22-23; US Br. 27. In most cases of plan default, however, the secured creditor's collateral often proves inadequate to cover completely the creditor's secured claim, let alone its collection costs. Rapid depreciation, combined with the other factors mentioned above, virtually assure that the secured party will not be paid in full if it is forced to assert its rights against its collateral.

It is certainly true that, in the cram-down context, a secured creditor is not faced with all of the costs of issuing a new loan. Pet. Br. 45; US Br. 23. But these savings are more than offset by the costs of delay and collection associated with the chapter 13 process. *See GMAC v. Jones*, 999 F.2d at 68-69 (making this point). Because the market-rate approach is the only method that approximates the true risks and costs of chapter 13 plans, it should be adopted under section 1325(a)(5)(B).[10]

3. The Sub-Prime Lending Market Serves High-Risk Borrowers and a Contract Rate Set in this Market Offers an Appropriate Proxy to Establish a Presumptive Rate in Chapter 13 Cases.

As noted, application of the cram-down option under section 1325(a)(5)(B) effects an involuntary extension of the secured creditor's loan on modified terms. Although Petitioners and their *amici* suggest that the terms of this extension are often more beneficial to the secured lender than those of the original loan

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10. In support of their arguments, Petitioners and their *amici* rely on a passage from the Collier treatise, 8 *Collier*, ¶ 1325.06[3][b] at 1325-37. Pet. Br. 36; US Br. 23. Without considering the high default rate of chapter 13 debtors, or the high collection costs associated with such default, the treatise suggests that the secured creditor's risk "need not be large." *Collier*, at 1325-37. For the reasons discussed, this analysis is in error.

(thus justifying a reduced rate), the opposite is plainly true in the vast majority of chapter 13 cases. There is thus no reason to believe that, in most instances, the interest rate payable under section 1325(a)(5)(B)(ii) should be less than the rate that the secured creditor accepted in making the loan in the first place. *Cf. Rash*, 520 U.S. at 962-63 (suggesting that interest rates in bankruptcy should be higher).

Further, although the risks and costs of the chapter 13 procedure are likely to be significantly greater than those the lender originally accepted in making its initial lending decision, the old contract rate (as compared to the formula rate, the prime rate, the Treasury-bill rate, or the creditor's cost of funds) will best approximate the true risks and costs of the proposed involuntary extension of credit. This is particularly so where, as here, the loan was executed relatively contemporaneously with the borrowers' bankruptcy filing. Similarly, where, as here, the contract rate was set on the basis of the debtor's poor credit history, the debtor's circumstances have not improved, and no lender would actually lend on the terms proposed in the debtor's plan, the old contract rate clearly is more probative than the alternatives of an actual market rate. Because most chapter 13 cases fit this description, the contract rate should serve as the presumptive rate unless the debtor or the creditor shows by persuasive evidence that the actual market rate would be higher or lower.

Petitioners and their *amici* argue that the contract rate does not control because the task at hand is to determine the value of the debtor's promise of future payment under the plan, not the payment promised under the original loan. US Br. 16, 18. *See also* Pet. Br. 28-30; AARP Br. 28; NACBA Br. 21. This misses the point. The properly controlling rate is the market rate, and the old contract rate is evidence of at least *some* market rate between the parties. Absent a demonstration that the debtor's circumstances have changed sufficiently to warrant a different market rate, the old contract rate will presumptively serve as the best evidence of a market rate.

Lenders such as SCS are in the business of making loans to "sub-prime" borrowers, such as the Tills, who do not qualify for credit under traditional lending criteria. *See* Press Release, *OCC Addresses Subprime Lending Risk Issues* (April 5, 1999) (quoting Comptroller John D. Hawke, Jr.) (defining the characteristics of a sub-prime borrowers). These borrowers "typically have weakened credit histories that include payment delinquencies, and possibly more severe problems such as charge-offs, judgments, and bankruptcies." *Interagency Expanded Guidance* at 2-3.

Like other borrowers, high-risk debtors often require financing in order to make necessary purchases, including the purchase of an automobile. Although the interest rates that SCS and other sub-prime lenders charge may appear to be high, these rates merely reflect the high-risk nature of the borrowers involved in the lending transactions at issue. *See Risks Associated with Subprime Lending*, FDIC Financial Institution Letter (May 22, 1997), *available at http://www.fdic.gov/news/news/financial/1997/fil9744.html* ("Foremost among the risks is a greater likelihood for defaulted loans and any attendant losses.").

Accordingly, sub-prime lenders such as SCS typically charge interest at rates equal to the maximum legal rate in the jurisdictions in which they do business. In Indiana, where SCS operates, the maximum rate under the Indiana Consumer Credit Code is 21%. Ind. Code Ann. § 24-4.5-3-201. This rate enables SCS to serve many high-risk borrowers, such as the Tills, to whom lenders otherwise would be unwilling to extend credit.

Moreover, the 21% rate allowed under Indiana law is similar to the rates allowed in other states. Although states use different means of prescribing maximum interest rates, including general retail installment sales acts, specific motor vehicle sales acts, and consumer credit codes, the laws fall generally into three groups. The largest group, comprising over twenty states, allows

a rate agreed upon by the parties to the transaction.[11] Fifteen states and the District of Columbia set a specific rate that ranges from 18 to 25%.[12] Thirteen states use a class system based on the age of the vehicle being purchased, in which older vehicles are subject to the highest rates.[13]

Despite lending at rates that approach or equal state maximums, sub-prime lenders typically underperform banks that lend at prime rates. For example, sub-prime lenders are "[n]early twice as likely to be unprofitable." John Lane, Assoc. Dir., Division of Supervision, FDIC, *Address at the National Automotive Finance Association Non-Prime Lending Conference* (June 18, 2002). This is due largely to the fact that sub-prime lenders live with delinquency rates on used-car loans that are approximately five times greater than the delinquency rates of new-vehicle loans offered almost exclusively by prime lenders. *See* Ted Craig, *Subprime Loan Business Offers Profits, Peril*, UCH-Headline News (July 1, 2002), *available at* http://eusedcarnews.com; *CBA Automotive Finance Study Show Tighter Approval Standards*, Consumer Bankers Association (May 6, 2003), *available at* http://www.cbanet.org/news. In many of these instances, lenders such as SCS are forced to incur collection costs. Nevertheless, both the rate of default and the associated costs are typically less in non-bankruptcy settings than the rate of plan default and the associated costs in the chapter 13 context.

Under the collection laws of most states, secured lenders enjoy quick and inexpensive rights of collection against their

11. These states, and the relevant statutory provisions, are set forth in chart form in the accompanying Addendum B.

12. These states, and the relevant statutory provisions, are set forth in chart form in the accompanying Addendum C.

13. These states, and the relevant statutory provisions, are set forth in chart form in the accompanying Addendum D.

collateral, including rights of repossession. *See* Ind. Code Ann. § 26-1-9.1-609; *United States v. Whiting Pools*, 462 U.S. 198, 207 n.14 (1983) (discussing secured creditor's right to take possession of its collateral). Outside the bankruptcy context, sub-prime lenders typically do not have the need to hire counsel to represent them in individual cases. In bankruptcy, the opposite is true, precisely because, as explained, an attorney must request relief from the court on behalf of the lender in order to pursue the creditor's rights.

When Congress enacted the Bankruptcy Code in 1978, it abandoned the prevailing philosophy under the former Bankruptcy Act that judges or administrative officials could properly fix payment entitlements. *Bank of Am. Nat'l Trust & Sav. Assoc. v. 203 North LaSalle St. P'ship*, 526 U.S. 434, 458 n.28 (1999) (stating that, when it enacted the Code, "Congress adopted the view that creditors and equity security holders are very often better judges of the debtor's economic viability and their own economic self-interest than courts, trustees, or the SEC") (internal quotation marks and citation omitted). Secured creditors operating in a competitive market are simply in a better position to evaluate the risks inherent in a particular repayment proposal than is a bankruptcy court. *See In re Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990) ("Judges are neither bankers nor lenders and do not have the expertise to set interest rates."). If negotiation does not yield an agreeable interest rate between the creditor and debtor, then the market — not the discretion of a judicial officer — provides the best alternative as a check on the parties' competing views. Because the old contract rate approximates the market standard, it should control presumptively in the absence of evidence of a higher or lower market rate available to the debtor.

Petitioners and their *amici* suggest unfairly that high-rate car loans are often the product of "predatory lending" and interest-rate "gouging." Pet. Br. 16-17 & n.14. The fact, however, that some borrowers outside the bankruptcy context may be eligible for lower interest rates than they agree to pay in financing

the purchase of used vehicles does not undermine the reality that, in the bankruptcy context, the typical chapter 13 plan offers only a very risky prospect of repayment. Moreover, under the market-rate standard adopted by the court below, a more creditworthy chapter 13 debtor is free to demonstrate that he or she deserves a lower interest rate (for example, because the value of the collateral vastly exceeds the amount of the debt that it secures, thereby materially lowering the secured creditor's risk). Where, as here, the debtor can make no such showing, and the old contract rate most accurately reflects the debtor's circumstances, the old rate should control.[14]

B. Section 1325(a)(5)(B) Should Be Construed Consistently with the Code's Other Provisions Designed to Protect the Rights of Secured Creditors.

Like other chapters of the Bankruptcy Code, chapter 13 does not require secured creditors to sacrifice the economic value of their security to subsidize the debtor's reorganization attempt. To be sure, the Code allows the debtor to modify the rights of secured parties. But the Code also prescribes explicit limitations on this power that conform to an overarching principle: although a secured creditor might not receive the literal terms of his bargain, "the secured creditor is entitled to receive in value essentially what he bargained for." H.R. Rep. No. 95-595 (1977),

14. Petitioners and their *amici* suggest that Congress's rejection of a proposal in 1984 to establish the contract rate as the definitive rate under section 1325(a)(5)(B)(ii) demonstrates that the contract rate should never apply. Pet. Br. 35; US Br. 14 n.6; AARP Br. 10. The fact that Congress rejected that particular proposal, however, suggests nothing about what Congress intended when it actually enacted the Code in 1978. *See Russello v. United States*, 464 U.S. 16, 23 (1983) ("the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one"). Indeed, it is perfectly plausible that Congress believed the proposal to be unnecessary. It is also perfectly plausible that Congress rejected the proposal because it would harm secured creditors in instances in which the prevailing market rate would be greater than the contract rate.

reprinted in 1978 U.S.C.C.A.N. 5963, 6295. *See also* 4 *Collier*, ¶ 506.02 at 506-08 ("the protections afforded secured creditors under the Code generally adhere first to the principle that the secured creditor is entitled to priority payment out of its collateral, and second to the principle that the secured creditor is entitled to receive the equivalent value of its collateral").

Section 1325(a)(5) is one of several provisions that collectively enforce this principle in chapter 13 cases. There is no reason to conclude that Congress intended to erode this basic concept in the post-confirmation context, or otherwise require a secured party to accept less than an interest rate that reflects the true risk of the debtor's payment promise under its plan. Because the governing statutory text requires the payment of full value, and because the payment of a market rate of interest is necessary to ensure that the secured creditor receives economically the full value of a secured claim, that is the appropriate standard here.

As the Court has instructed repeatedly, the provisions of the Bankruptcy Code must be construed "holistically," taking into account the relationship between various provisions as well as their collective object and policy. *See United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 369-71 (1988) (construing sections 361, 362 and 506 of the Code and observing that "[s]tatutory construction is a holistic endeavor"); *Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.") (citations and internal quotation marks omitted); *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 218 (1936) ("To fix the meaning of these provisions [of the Bankruptcy Act] there is need to keep in view the background of their history. There is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts.").

In a series of provisions, the Bankruptcy Code prescribes special rights and protections for the holders of "secured claims." Collectively, these provisions demonstrate Congress's effort to strike a balance between affording debtors the opportunity to modify the rights of secured parties to facilitate bankruptcy plans and preserving for secured creditors the full economic value of their rights. Because the market-rate approach best assures that a secured creditor will receive the full value of its rights under section 1325(a)(5)(B), it is the only approach that is fully consistent with these provisions.

First, during the pendency of a bankruptcy case, and before confirmation of any plan, a secured party may be entitled to "adequate protection" in the form of payments or other relief if the debtor's continued use of the collateral threatens to cause a decline in the value of the collateral to the detriment of the secured party while the secured party is prevented from taking possession on account of the automatic stay. 11 U.S.C. §§ 361, 363(e); *Whiting Pools*, 462 U.S. at 204 ("At the secured creditor's insistence, the bankruptcy court must place such limits or conditions on the [debtor's] power to sell, use, or lease property as are necessary to protect the creditor."). For example, if the collateral is depreciating as a result of the debtor's continued use pending approval of a chapter 13 plan, the debtor may be required to make periodic payments to the secured creditor in an amount equal to at least the rate of depreciation, so that the secured party's collateral position is maintained. *See* 4 *Collier*, ¶ 506.03[7][a] at 506-53 through 506-59 (illustrating concepts and providing examples).[15]

15 Similarly, although the automatic stay generally enjoins debt-collection activity during the case, the Bankruptcy Code also provides that, under certain circumstances, a secured creditor may be entitled to stay relief to enforce its non-bankruptcy rights. 11 U.S.C. § 362(d). Under the statute, a creditor is entitled to relief to enforce its rights if the debtor cannot provide "adequate protection" to the secured party to protect its collateral position, or if the debtor has no equity in the collateral and the property is not necessary for reorganization. *Id.*; *see Timbers*, 484 U.S. at 375-76; 4 *Collier*, ¶ 506.03[7][b] at 506-62 through 506-68.

The concept of adequate protection under sections 361 and 363(e) shelters the secured party from the beginning of the bankruptcy case through confirmation of the debtor's chapter 13 plan. At that point, the requirements of section 1325(a)(5)(B) take over. There is no reason to believe that, having preserved the secured party's position up to the point of confirmation, Congress thereafter intended to force the secured party to subsidize the debtor's retention of collateral through imposition of a substandard interest rate. On the contrary, as this Court has explained, "[t]he reorganized debtor is supposed to stand on his own two feet." *Timbers*, 484 U.S. at 378.

Second, as a general rule, creditors are not entitled to accrue interest on claims during a debtor's bankruptcy case between the date the debtor commences its case and the confirmation of any plan. *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163 (1946) ("The general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings.").

Section 506(b) of the Code, however, prescribes an exception for "oversecured" claims. Specifically, a secured creditor is entitled to accrue interest during the case to the extent that the value of its collateral exceeds the amount of its secured claim. 11 U.S.C. § 506(b); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 239-40 (1989). For oversecured claims, the relevant rate of interest is the contract rate. *See Bradford v. Crozier (In re Laymon)*, 958 F.2d 72, 75 (5th Cir. 1992); *Ruskin v. Griffiths*, 269 F.2d 827, 831-32 (2d Cir. 1959); 3 *Collier*, ¶ 506.04 at 506-109.

Like the concept of adequate protection under sections 363(e) and 361, the interest rule of 506(b) applicable to oversecured claims carries the secured party from the beginning of the bankruptcy case through the confirmation of the debtor's plan. At that point, the interest rate is subject to adjustment, based on prevailing market conditions, in order to ensure that,

if the debtor proposes to compel the secured creditor to extend its loan on modified terms, the secured creditor will receive the true value of its secured claim. Because in some cases this may require a rate of interest higher (or lower) than the old contract rate, section 1325(a)(5)(B)(ii) does not require payment of the old contract rate.

Like 506(b), section 1325(a)(5)(B) operates to preserve for the secured creditor the value of its economic bargain. Because the context (confirmation) is different, however, the statute operates in a different way. Specifically, section 1325 offers the debtor flexibility in adjusting the terms of repayment by forcing an extension of the loan on modified terms. Nevertheless, by its terms, section 1325 also aims to preserve for the secured creditor the full economic value of its bargain — to have the benefit of the full value of its collateral.

Third, in chapter 7 liquidation cases, section 725 directs that a trustee shall dispose of a secured party's collateral. 11 U.S.C. § 725. As the legislative history explains, "[t]he purpose of this section is to give the court appropriate authority to ensure that the collateral or its proceeds is returned to the proper secured party." H.R. Rep. No. 95-595 at U.S.C.C.A.N. 6338. In substance, section 1325(a)(5)(B) requires essentially the same thing by directing that the secured creditor receive the full "value" of its secured claim. Again, the difference is that, under section 1325, the debtor is afforded flexibility in modifying the payment terms. Nevertheless, the underlying principle of protecting the secured creditor's economic return from its collateral remains the same.

In an effort to undermine the protection that section 1325(b)(5)(B)(ii) requires, Petitioners and their *amici* refer to other sections of the Code and suggest that these provisions demonstrate an intent to reduce the value of the secured creditor's interest in its collateral. Pet. Br. 19; US Br. 13; AARP Br. 11-15. The fact that the debtor may generally modify the

rights of secured parties under section 1322(b)(2), however, is qualified by section 1325(a)(5)(B)(ii), and there is no basis to conclude that the former overrides the latter. On the contrary, the two must be construed together, and section 1325(a)(5)(B)(ii) must be given effect. *E.g.*, *Kelly*, 479 U.S. at 43.

Similarly, the fact that section 362(d)(3)(B) specifically provides for the payment of interest at a "fair market rate" as a means of providing adequate protection, whereas section 1325(a)(5)(B)(ii) uses the term "value," does not preclude the term "value" from requiring the payment of a market rate of interest. Unlike section 362(d)(3)(B), the function of section 1325(a)(5)(B)(ii) is to provide a standard to measure the present value of a proposed future stream of payments. Not surprisingly, the terminology used in the different provisions is distinct.[16]

Finally, contrary to the argument of *amicus* AARP, there is no clash between the use of the term "value" in section 1325(a)(5)(B)(ii) and section 1325(a)(4). Section 1325(a)(4) requires that, in order for the debtor's plan to be confirmed, the debtor's proposed future payments to unsecured creditors must not be less than the immediate distribution that unsecured creditors would receive from the liquidation of the debtor's property in a chapter 7 case. In conducting this comparison, the analysis under sections 1325(a)(5)(B)(ii) and 1325(a)(4), however, is the same: the court must discount the stream of proposed payments under the debtor's chapter 13 plan using an appropriate interest rate in order to determine the stream's present value. The court then compares the present value to the likely value of any distribution that unsecured creditors would receive in a chapter 7 case. So long as the present value of the chapter 13 payments is greater, section 1325(a)(4) is satisfied. In determining an appropriate interest rate, the court need simply select the market rate for unsecured loans available to the debtor.

16. For the same reason, the fact that section 506(b) expressly requires the payment of interest on oversecured claims at the rate set forth in the creditor's contract also is inapposite.

Moreover, because general unsecured creditors share *pro rata* from distributions available to them as a class, the court need only select one rate for the class.

The discounting procedure under section 1325(a)(4), however, is rarely (if ever) employed, for the simple reason that the overwhelming majority of debtors who file for chapter 13 relief would not provide any distribution to general unsecured creditors in a chapter 7 case because they have no unencumbered, non-exempt assets. Thus, by merely making a single distribution to unsecured under a chapter 13 plan, most debtors will satisfy the test of section 1325(a)(4). *Cf. Timbers*, 484 U.S. at 379 (dismissing anomalous result as so exceedingly rare as to be most likely "the product of inadvertence").

C. The History of Section 1325 Supports a Market-Based Cram-Down Rate.

This Court has recognized that, "[w]hen Congress amends the bankruptcy laws, it does not write 'on a clean slate.'" *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (quoting *Emil v. Hanley*, 318 U.S. 515, 521 (1943)). The Court has further acknowledged the importance of the history and development of bankruptcy jurisprudence by presuming that provisions of the Bankruptcy Code will carry the same meaning as their predecessors unless Congress clearly intended a change. *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) ("We . . . 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure. . . .'") (quoting *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990)); *United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 221 (1996) ("Congress could, of course, have intended a different interpretive method for reading terms used in the Bankruptcy Code it created in 1978. But if it had so intended we would expect some statutory indication. . . .").

Chapter 13 derives from former provisions of chapter XIII of the Bankruptcy Act of 1898. Under old chapter XIII, rights of secured creditors could not be altered without the secured creditor's consent. *See General Fin. Corp. v. Garner (In re Garner)*, 556 F.2d 772, 779 (5th Cir. 1977); *In re Moran*, 121 B.R. 879, 882 (Bankr. E.D. Okla. 1991) ("Chapter XIII under the Bankruptcy Act also prohibited the treatment of claims secured by personal property unless the consent of the secured creditor was obtained by the debtor."); *In re Hernandez*, 175 B.R. 962, 965 (N.D. Ill. 1994). *See also* Hon. Roger M. Whelan et al., *Consumer Bankruptcy Reform: Balancing the Equities in Chapter 13*, 2 Am. Bankr. Inst. L. Rev. 165, 191 n.8 (1994). When Congress enacted the provisions of chapter 13, it modified the governing scheme by incorporating a cram-down provision borrowed from the corporate reorganization context. *See* 11 U.S.C. § 1129(b).

The cram-down provisions of the Code appearing in both sections 1129 and 1325 derive from the former cram-down provision of chapter X, which, in turn, derives from the former cram-down provision of section 77B applicable to corporate reorganization. Under section 77B(b)(5), a debtor could confirm a plan of reorganization in which the debtor retained a secured party's collateral over the objection of the secured party, so long as the plan provided "adequate protection for the realization . . . [by secured parties] of the value of their interests, claims, or liens." Bankruptcy Act of 1934, ch. 424, § 77B(b)(5), 48 Stat. 911, 914 (1934) (superseded by the Chandler Act of 1938).

The leading case interpreting this provision is Judge Learned Hand's decision in *Metropolitan Life Ins. Co. v. Murel Holding Corp. (In re Murel Holding Corp.)*, 75 F.2d 941 (2d Cir. 1935), in which the court held that, in order to be adequately compensated under this provision, the payments offered to the secured party "must be completely compensatory." 75 F.2d at 942. In reaching this conclusion, the court observed that "the

payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference. . . ." *Id.* The court also noted that the terms of the repayment had to compensate the secured party for its risk, and that the cram-down provision was not intended to force the secured party to shoulder uncompensated risk for the benefit of others. *Id.* ("We see no reason to suppose that [section 77B of the Bankruptcy Act] was intended to deprive [a creditor of principal plus interest or simply the property] in the interest of junior holders, unless by a substitute of the most indubitable equivalence."). Requiring a secured party to accept less than a market-based interest rate would violate this "indubitable equivalent" standard precisely because it would require the secured party to shoulder uncompensated risk for the benefit of others.

The legislative history indicates that Congress specifically intended to incorporate the concepts of *Murel* in enacting the cram-down provisions of the Code. H.R. Rep. No. 95-595 at U.S.C.C.A.N. 6475 ("[Section 1129(b)(2)(A)(iii)] requires the Court to confirm the plan notwithstanding the dissent of the electing secured class if the plan provides for the realization by the secured class of the indubitable equivalence of the secured claims. The standard of "indubitable equivalence," as set forth in 28 U.S.C. § 1129(b)(2)(A)(iii), is taken from *In re Murel Holdings Corp.*, 75 F.2d 941 (2d Cir. 1935). *See also Timbers*, 484 U.S. at 378 ("Of course *Murel*, like [the cram-down provisions of chapter 11], proceeds from the premise that in the confirmation context the secured creditor is entitled to present value."). Consistent with the historical underpinnings of the cram-down provision, the debtors' plan in this case, in order to be "completely compensatory," must provide SCS with a true market rate of interest. Absent a rate of interest set by the market, SCS would be compelled improperly to shoulder uncompensated risk for the benefit of the debtors and other

creditors because SCS would not be receiving the full "value" of its secured claim.

Petitioners and the United States argue that *Murel* is inapplicable in the context of a cramdown in chapter 13. Pet. Br. 37-38; US Br. 18 n.9. Specifically, Petitioners contend that "the precedential value [of] *Murel* was dispelled by this Court in *Timbers*," which referenced only the importance of 'indubitable equivalence' with regard to the principal of the loan and not with reference to interest." Pet. Br. 37. The Court's holding on this point, however, was limited to situations in which the bankruptcy court is charged with preserving the value of the creditor's collateral from diminution during the period prior to confirmation of the debtor's plan. 484 U.S. at 377. In those situations, a creditor is not entitled under the Code to the immediate payment of the principal of its collateral, during which the status quo is simply preserved. *Id.* The Court noted, however, that interest payments *are necessary* when a creditor's interest is assessed in the debtor's plan. "Under this formulation, even though the undersecured creditor's 'interest' is regarded (properly) as solely the value of the collateral, he must be rendered payments that assure him that value as of the effective date of the plan." *Id.* Thus, the Court did not dispel *Murel* in the confirmation context, which is not the context in *Timbers* but is the context here.

D. The Policies of the Code Require that SCS Receive the Full Value of its Secured Claim.

As noted, the Bankruptcy Code embraces the policy of protecting the rights of secured creditors by ensuring that they receive the full "equivalent value" of their rights, and that they receive treatment that is "completely compensatory" in exchange for the deprivation of their non-bankruptcy collection entitlements. Allowing a debtor to keep a secured party's collateral, yet pay interest on a less-than-market rate basis, would violate these policies by effectively requiring the creditor to

subsidize the debtor's retention of its collateral. *See In re Roso*, 76 F.3d 179, 181 (8th Cir. 1996) ("By definition, a subsidized rate of interest is not a market rate of interest. It is a rate of interest *below* the market rate."). This would supply nothing less than a proscribed windfall for the debtor by allowing the debtor to reap the benefits of property without paying the market value for it. *See Butner v. United States*, 440 U.S. 48, 55 (1979) (a longstanding policy of bankruptcy law is to prevent a party from receiving "a windfall merely by reason of the happenstance of bankruptcy") (citing *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 609 (1961)); *Dewsnup*, 502 U.S. at 417-19 (bankruptcy law does not permit the gratuitous transfer of the value of a valid lien to the debtor); *Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries, Inc.)*, 50 F.3d 72, 76 (1st Cir. 1995) (a court cannot permit lien stripping that would create a windfall for the debtor); 4 *Collier*, ¶ 506.03[4][a][iii].

In this instance, if the Tills wished to rid themselves of their payment obligation to SCS, they could have surrendered the Chevy and discharged their indebtedness. 11 U.S.C. § 1325(a)(5)(c). Because they elected to keep the collateral, however, they must pay the market value for it, including the market rate of interest that reflects the true risk of forcing SCS to continue on as the Tills' secured lender. *See* Matthew Y. Harris, *Chapter 13 Cramdown Interest Rates: Another Day, Another Dollar — A Cry For Help In Ending The Quest For The Appropriate Interest Rate*, 67 Miss. L.J. 567, 580 (Winter 1997). In this context, forcing SCS to subsidize the debtors' interest rate would give the Tills a proscribed "head start," not a "fresh start." *See Taylor v. AGE Fed. Credit Union (In re Taylor)*, 3 F.3d 1512, 1516 (11th Cir. 1993) (a debtor is entitled to a fresh start, not a head start, and thus must provide for post-petition secured obligations); *In re Kokoszka*, 479 F.2d 990, 995 (2d Cir. 1973), *aff'd sub nom. Kokoszka v. Belford*, 417 U.S. 642 (1974); *Heller v. Foulston (In re Heller)*, 160 B.R. 655, 658

(D. Kan. 1993); 130 Cong. Rec. S8891 (daily ed. June 29, 1984), *reprinted in* 1984 U.S.C.C.A.N. 590, 598 (statement of Sen. Orrin G. Hatch) (indicating that numerous provisions were added to the Bankruptcy Code to ensure that the Code's "fresh start" does not become a "head start"). *See also Boston University v. Mehta (In re Mehta)*, 310 F.3d 308, 311 (3d Cir. 2002) (there are situations "where giving the debtor a fresh start in life is not the paramount concern and protection of the creditor becomes more important"); *In re Scott*, 294 B.R. 620, 628 (Bankr. W.D. Pa. 2003); *In re Coonce*, 213 B.R. 344, 349 (S.D. Ill. 1997).

Contrary to the arguments of Petitioners and their *amici*, the Code's policy of equality of distribution is not at stake. *See Young v. Higbee*, 324 U.S. 204, 210 (1945) ("historically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets"). As explained in Collier, "[c]onceivably, Congress might have adopted a bankruptcy system that abolished distinctions between secured and unsecured debt, leaving all creditors to receive essentially the same treatment on more or less of a pro rata basis. . . . Congress, however, has not chosen such a system." 4 *Collier*, ¶ 506.02 at 506-8. Instead, "[a]s stated in the legislative history to section 361: 'Secured creditors should not be deprived of the benefit of their bargain.'" *Id.* (quoting H.R. Rep. No. 95-595 at U.S.C.C.A.N. 6295). Moreover, there is no basis for attempting to elevate the policy of equality of distribution applicable to unsecured claims to erode the protections afforded secured parties under section 1325(a)(5)(B). *See In re Greystone III Joint Venture*, 995 F.2d 1274, 1280 (5th Cir. 1992) ("'Policy' considerations do not justify preferring one section of the Code, must less elevating its implicit 'policies' over other sections, where the statutory language draws no such distinctions.").

E. Application of a Market-Rate Standard Is Economically Efficient.

Like other sub-prime lenders, SCS holds a portfolio of loans, and the risks and costs of any particular borrower are spread among the total number of borrowers in its portfolio. Because lenders such as SCS have numerous loans, they may accept some applicants that are riskier than average, and the risks associated with these applicants are offset by the lower risks of other members of the pool. Notwithstanding its ability to spread risks and costs, however, lenders such as SCS do not approve all applicants. Some applicants are simply too risky to include in the lending pool, particularly given the cap on interest rates imposed by the laws of many states (here 21%), and the fact that lenders such as SCS do not themselves have access to unlimited, cost-free funds.

Petitioners and their *amici* argue that chapter 13 debtors should pay rates of interest lower than non-bankrupt sub-prime borrowers because the risks and costs of default are already built into the interest rates that the lender charged initially. But this ignores the fact that, because of the debtor's bankruptcy, the lender's collection of its contract rate of interest from the particular debtor has been interrupted. Hence, the particular debtor has *not* already "paid for" its potential default. Indeed, the opposite is true. Because SCS will never collect the Tills' debt in full (e.g., because SCS is an undersecured creditor, nearly $1,000 of its claim was stripped off and placed in the unsecured class and will not be paid in full), SCS will, at best, sustain a significant loss on the account.

Moreover, it makes no economic sense that chapter 13 debtors should be rewarded with interest rates that are lower than other high-risk members of the sub-prime lending pool who manage to avoid bankruptcy. As a matter of economic reality, the costs of default associated with chapter 13 cases must be absorbed somewhere. Because interest rates for the lending

pool are typically capped at a maximum rate, the inevitable result of mandating lower interest rates for chapter 13 debtors is that fewer sub-prime borrowers will be able to obtain financing. *See* Richard M. Haynes, *Optimal Bankruptcy in a Non-Optimal World*, 44 B.C. L. Rev. 1, 18 (2002) ("Because lending markets are highly competitive and money can be readily invested outside the consumer lending market, debtors are more likely to bear most if not all of the cost of bankruptcy protection in the form of higher interest rates or reduced access to credit."); Reint Gropp et al., *Personal Bankruptcy and Credit Supply and Demand*, 112 Q.J. Econ. 217, 245 (1997) (empirical study finding correlation between generous state bankruptcy exemptions and lack of credit available to low-asset households).

This is so because, in order to maintain any profit margin, the lender will be forced to be more selective in its lending decisions to the extent the lending pool is forced to subsidize interest rates to chapter 13 debtors. *See In re Thompson*, 867 F.2d 416, 419 (7th Cir. 1989); *In re Patterson*, 825 F.2d 1140, 1142 (7th Cir. 1987); *cf. Official Comm. of Unsecured Creditors of LTV Steel Co., Inc. v. Valley Fidelity Bank & Trust Co. (In re Chateaugay Corp.)*, 961 F.2d 378, 382 (2d Cir. 1992). Moreover, forcing secured lenders to subsidize interest rates in bankruptcy would only encourage bankruptcy filings for those who simply wish to reduce their interest rates, thus exacerbating the problem. *See Lewis*, 364 U.S. at 608; *In re Carlton*, 211 B.R. 468, 475 (Bankr. W.D.N.Y. 1997) (noting that "fewer and fewer individual consumer debtors have been forced into bankruptcy because of a recent catastrophic event" and that "more and more [chapter 13 debtors] appear to have filed because it is the only way that they can . . . cram down personal property liens, such as on their vehicles"). Thus, mandating artificially low interest rates would only ensure "that even less [financing] will be supplied." Sowell, *supra* at 41.

Thus, while the interest rates that sub-prime lenders charge may appear high, this merely reflects the risks that they assume

in servicing the sub-prime market. *See* Haynes, *supra*, at 18. As one commentator has explained, "[p]eople shocked by . . . the much higher interest rates charged by pawnbrokers and the small finance companies that [serve certain borrowers], as compared to the interest rates charged by banks, have been quick to blame greed or exploitation on the part of the people who run such businesses." Sowell, *supra*, at 40. "Yet studies show that profit rates are no higher [for these businesses] than elsewhere . . ." *Id.*

F. Use of a Market-Rate Standard Is the Most Practical Approach.

The market-based approach to the interest-rate determination is also the most practical of the alternatives, as it is merely an extension of the procedure mandated by this Court in *Rash*, 520 U.S. at 964, for determining the replacement value of a secured creditor's collateral in chapter 13 cram-down cases. Under *Rash*, if a debtor proposes to retain collateral securing a claim, the bankruptcy court is required to determine the replacement value of the collateral in order to determine the principal amount of the creditor's secured claim. In the absence of an agreement among the parties, the court must take evidence on "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller." *Rash*, 520 U.S. at 960.

When they purchase vehicles, most borrowers finance at least a portion of the purchase price. In the chapter 13 context, if the debtor proposes to retain collateral securing a claim, and likewise proposes to pay the principal amount of the creditor's secured claim over time, the bankruptcy court may fix the appropriate rate of interest merely by determining the rate that a willing borrower in the debtor's trade, business, or situation would pay to obtain financing from a willing lender. In this case, the unrebutted evidence is that a lender would charge the Tills not less than 21%. JA 47-48. In the absence of such evidence, the old contract rate may presumptively control.

It makes little practical sense, and would lead only to confusion, for courts to apply a market-based standard for determining the replacement value of a creditor's collateral, as required by *Rash*, and a different standard for determining the amount of interest accruing on that collateral. Moreover, the market-rate approach is consistent with the overarching rationale of *Rash*, that "a simple rule of valuation is needed to serve the interests of uniformity and predictability." 520 U.S. at 965 (internal citations omitted).

In contrast, the alternative approaches that Petitioners and their *amici* advocate are both impractical and arbitrary. Here, the Tills simply offered a 9.5% rate at the confirmation hearing, with no apparent justification other than that the rate suited them. Because the court is required to hold a confirmation hearing regardless of the approach, the procedure should be one defined by a clear standard, which the market-rate approach offers. Not only is this simpler to apply, it also will foster negotiation and agreement over the relevant rate, short of litigation.

Petitioners and their *amici* suggest that the market-rate approach is impractical because it may require the establishment of different interest rates among different secured creditors. Pet. Br. 21-22; US Br. 19; AARP Br. 24; NACBA Br. 23. But that is no different than what the debtors actually proposed in this case: two secured creditors to receive 9.5%, and two to receive 0%. JA 12. Moreover, depending on such factors as whether the particular creditor's collateral vastly exceeds the amount of its debt, different secured creditors may be entitled to different rates because their risks are different. The market approach provides a logical and practical standard that can be used to make these distinctions, and thus, is preferable.

G. The Failure to Apply a Market Rate Would Be Inequitable.

It is not inequitable for a secured creditor to receive the full equivalent value of its bargain as the holder of a secured claim. *See Chemical Bank N.Y. Trust Co. v. Kheel*, 369 F.2d 845, 848 (2d Cir. 1966) ("Equality among creditors who have lawfully bargained for different treatment is not equity but its opposite . . .") (Friendly, J., concurring). Underlying the "equity" arguments of the Petitioners and their *amici* is a thinly veiled antagonism towards the rights of secured creditors in the bankruptcy context. But it is not for the bankruptcy courts to rewrite the protections that Congress has provided. *See Grupo Mexicano de Desarrollo v. Alliance Bond Fund*, 527 U.S. 308, 332-33 (1999) (the measure of the law is not the chancellor's foot). Similarly, bankruptcy courts simply do not possess the authority to set artificially "just" or "fair" prices. *See BFP*, 511 U.S. at 540 (bankruptcy courts do not have authority to ignore market price in favor of a "fair" price); *City of New York v. Sage*, 239 U.S. 57, 61 (1915) (market price is not "what a tribunal at a later date may think a purchaser would have been wise to give").

Moreover, there is simply nothing unfair or inequitable about requiring a chapter 13 debtor to pay the same market rate for financing that non-debtors must pay. Indeed, it is the opposite proposition that would be unfair.

The Tills have alternatives if they do not wish to be burdened with the obligation of paying SCS's secured claim at a market rate of interest: they can surrender the collateral and discharge any debt that they may owe. If they wish to retain the Chevy, however, they are not entitled to a subsidy. There is no injustice in this result.

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Seventh Circuit should be affirmed.

Respectfully submitted,

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ADDENDUM A

RELEVANT STATUTORY PROVISIONS

11 U.S.C. § 361 provides in relevant part:

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by –

> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
>
> (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 362 provides in relevant part:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of —

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

(c) Except as provided in subsections (d), (e), and (f) of this section—

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and

(2) the stay of any other act under subsection (a) of this section continues until the earliest of —

(A) the time the case is closed;

(B) the time the case is dismissed; or

(C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied.

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay —

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if —

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization; or

(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) —

(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) the debtor has commenced monthly payments to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien), which payments are in an amount equal to interest at a current fair market rate on the value of the creditor's interest in the real estate.

11 U.S.C. § 363(e) provides:

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).

11 U.S.C. § 506(b) provides:

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 725 provides in relevant part:

After the commencement of a case under this chapter, but before final distribution of property of the estate under section 726 of this title, the trustee, after notice and a hearing, shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title.

11 U.S.C. § 1129 provides in relevant part:

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims —

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests —

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

11 U.S.C. § 1307 provides in relevant part:

(a) The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable.

(b) On request of the debtor at any time, if the case has not been converted under section 706, 1112, or 1208 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable.

11 U.S.C. § 1322 provides in relevant part:

(a) The plan shall —

(1) provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim; and

(3) if the plan classifies claims, provide the same treatment for each claim within a particular class.

(b) Subject to subsections (a) and (c) of this section, the plan may —

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class

so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(6) provide for the payment of all or any part of any claim allowed under section 1305 of this title;

(7) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(8) provide for the payment of all or part of a claim against the debtor from property of the estate or property of the debtor;

(9) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity; and

(10) include any other appropriate provision not inconsistent with this title.

(d) The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.

11 U.S.C. § 1325 provides in relevant part:

(a) Except as provided in subsection (b), the court shall confirm a plan if—

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan —

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; and

(6) the debtor will be able to make all payments under the plan and to comply with the plan.

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan —

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended —

(A) for the maintenance or support of the debtor or a dependent of the debtor, including charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to a qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)) in an amount not to exceed 15 percent of the gross income of the debtor for the year in which the contributions are made; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

ADDENDUM B

MAXIMUM RATE SET BY CONTRACT

State Statute	Maximum Rate
ALA. CODE § 8-8-5 (2002)	rate set by contract for loans of $2,000 or more
ARIZ. REV. STAT. ANN. § 44-291 (West 2003)	rate set by contract
CO. REV. STAT. ANN. § 5-12-103 (2002)	rate set by contract, but not to exceed 45% per year
DEL. CODE ANN. Tit. 5, § 2908 (2002)	rate set by contract
HAW. REV. STAT. ANN. § 478-2 (Michie 2000)	rate set by contract
IDAHO CODE § 28-42-201 (Michie 1999 & Supp. 2003)	rate set by contract
815 ILL. COMP. STAT. ANN. 375/21 (West Supp. 2003)	no limit
KAN. STAT. ANN. § 16-201 (West 1995 & Supp. 2002)	rate set by contract
MO. ANN. STAT. § 365.120 (1997 & Supp. 2003)	rate set by contract
MONT. CODE ANN. § 31-1-241 (2001)	rate set by contract
NEV. REV. STAT. 97.195 (Michie 2001)	rate set by contract
N.H. REV. STAT. ANN. § 361-A:8 (Supp. 2002)	rate set by contract
N.J. STAT. ANN. §§ 17:16C-40.1, 41 (West 1996)	rate set by contract for loans up to $10,000, but may not increase more than 6% over life of loan or more than 3% in any 12-month period

N.M. STAT. ANN. § 56-8-3 (Michie Supp. 2003)	rate set by contract
N.Y. PERS. PROP. LAW § 303 (McKinney Supp. 2003)	rate set by contract
N.D. CENT. CODE § 51-13-03 (1999)	rate set by contract
OR. REV. STAT. § 83.565 (2001)	rate set by contract
S.D. CODIFIED LAWS § 54-3A-3 (Michie 2001)	rate set by contract
UTAH CODE ANN. § 70C-2-101 (2001)	rate set by contract
VA. CODE ANN. § 6.1-330.60 (Michie Supp. 2003)	rate set by contract
WASH. REV. CODE ANN. § 63.14.130 (West Supp. 2003)	rate or dollar amount set by contract
WISC. STAT. ANN. § 422.201 (West Supp. 2002)	no limit

ADDENDUM C

SPECIFIC RATE SET

State Statute	Maximum Rate
ARK. CONST. OF 1874, ART. XIX, § 13(B)	17%
D.C. CODE ANN. § 28-3602 (Supp. 2001)	21%
FLA. STAT. ANN. § 520.08 (West 2002)	21%
MD. CODE. ANN., COM. LAW I § 12-609 (2000)	18%
MICH. COMP. LAWS ANN. § 445.1854 (West 2002)	21%
MINN. STAT. ANN. § 168.72 (West Supp. 2003)	25%
NEV. REV. STAT. 97.195 (Michie 2001)	18%
N.D. CENT. CODE § 51-13-03 (1999)	18% for loans of $3,000 or more
OKLA. STAT. ANN. tit. 14A, § 3-508A (West 1996 & Supp. 2003)	25%
OR. REV. STAT. § 83.565 (2001)	21%
S.C. CODE ANN. § 37-2-201 (Law. Co-op. 2002)	21%
S.D. CODIFIED LAWS § 54-3A-3 (Michie 2001)	18%
TEX. FIN. CODE ANN. § 348.104 (Vernon 1998 & Supp. 2003)	17.5%
VA. CODE ANN. § 6.1-	18%

330.60 (Michie Supp. 2003)	
WISC. STAT. ANN. § 422.201 (West Supp. 2002)	18%
WYO. STAT. ANN. § 40-14-212 (Michie 2003)	21%

ADDENDUM D

RATE BASED ON CLASS OR OTHER

Statute	Maximum Rate
ALASKA STAT. § 45.45.010 (Michie 2002)	for loans under $25,000, no more than 5% above the rate charged member banks by 12th Fed. Reserve Dist.
CAL. CIVIL CODE § 2982 (West Supp. 2003)	rate varies based on how interest is computed; e.g., for loans over $2,000, $25 per month if precomputed or $75 per month if simple interest
CONN. GEN. STAT. ANN. § 36a -772 (West Supp. 2003)	15% for new motor vehicles; 17% for used vehicles less than 2 years old; 19% for other used vehicles
FLA. STAT. ANN. § 520.08 (West 2002)	cl. 1 - $10 per $100; cl. 2 - $11 per $100; cl. 3 - $15 per $100; cl. 4 - $17 per $100
GA. CODE ANN. § 10-1-33 (2000)	cl. 1 - $10 per $100; cl. 2 - $13 per $100; cl. 3 - $15 per $100; cl. 4 - $17 per $100
IOWA CODE ANN. § 322.19 (West 1997 & Supp. 2003)	cl. 1 - 1.75% per month simple interest; cl. 2 - 2%; cl. 3 - 2.25%
KY. REV. STAT. ANN. § 190.110 (Michie 1997 & Supp. 2002)	cl. 1 - $11 per $100 ; cl. 2 - $13 per $100; cl. 3 - $15 per $100
LA. REV. STAT. ANN. § 6:969.10 (West Supp. 2003)	cl. 1 - 18%; cl. 2 - 24%; cl. 3 - 27%; cl. 4 - 33%
MD. CODE. ANN., COM. LAW I § 12-609 (2000)	cl. 1 - 16.5%; cl. 2 - 22%; cl. 3 - 27%

MINN. STAT. ANN. § 168.72 (West Supp. 2003)	cl. 1 - 18%; cl. 2 - 19.75%; cl. 3 – 23.25%
MISS. CODE ANN. § 63-19-43 (West 1996 & Supp. 2000)	cl. 1 - 18%; cl. 2 - 21%; cl. 3 - 26.75%; cl. 4 - 28.75%
69 PA. CONS. STAT. ANN. § 619 (West Supp. 2003)	cl. 1 - 18%; cl. 2 - 18%; cl. 3 - 21%; cl. 4 - 7.5%; cl. 5 (mobile homes) - set by FHA; cl. 6 - 10%
TEX. FIN. CODE ANN. § 348.104 (Vernon 1998 & Supp. 2003)	the larger of $25 or cl. 1- $7.50 per $100; cl. 2 - $10 per $100; cl. 3 - $12.50 per $100; cl. 4 - $18 per $100

(12)

Supreme Court, U.S.
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No. 02-1016

In the Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

PETITIONERS' REPLY BRIEF ON THE MERITS

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QUESTIONS PRESENTED

Petitioners oppose Respondent's recasting of the "present value" or time value of money concept into an issue of "prevailing market rate."

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STATEMENT OF FACTS

Although the SCS allowed secured claim was projected to be paid within 17 months [Jt. App. 12 ¶ (c)(2)], the Trustee's records indicate that SCS received its initial distribution in August 2000, and that its allowed secured claim was paid in full (at 9.5% interest) on June 1, 2001 – within one year of the June 27, 2000 confirmation date. http://www.13network.com/indhome.htm.

Respondent did not admit the Retail Installment Contract into evidence in the Bankruptcy Court, and stood upon its witness's testimony that "Instant-Auto Finance [never] sells vehicles on credit other than to employees for a rate of interest less than 21 per cent [.]" (Jt. App. 47).

SUMMARY OF ARGUMENT IN REPLY

Respondent contends that state contractual or creditor-specific lending markets control the present value calculation, much like an extension of post-petition credit. Petitioners contend that the present value calculation under Chapter 13[1]

[1] The number of business reorganization filings in comparison to Chapter 13 filings is nominal [10,702 business Chapter 11s as compared to 451,258 total Chapter 13s reported for fiscal year 2002], http://www.uscourts.gov/judicialfactsfigures/table5.2.htm, and the monetary amounts at stake may justify higher costs of Chapter 11 administration. Unlike Chapter 13 with a standard 3-year and maximum 5-year term, Chapter 11 has no general term limitation and often involves no *periodic creditor payments which form the crux of the Chapter 13 present value analysis*. Under Chapter 11, confirmation discharges the debtor and frees the estate's property from all pre-petition claims. Should the plan fail, creditors may sue only on the obligations as stated in the plan, and pre-confirmation contracts are not revived. 3 Collier Bankruptcy Manual ¶ 1129.01[1] at 1129-3, 4 (3rd ed. rev. 1999). Under Chapter 11, the right

cramdown is not analogous to an extension of credit – it is neither consensual, contractual nor a loan – but exclusively a creature of statute to be determined in accordance with federal common or statutory law. The rates appropriate to the present value equation are easily accessed through market-sensitive national indices.

ARGUMENT IN REPLY

I. NATIONAL INDICES RATHER THAN STATE-LAW CONTRACT OR CREDITOR-SPECIFIC LENDING CRITERIA CONTROL

Respondent bears the "exceptionally heavy burden" of establishing that Congress intended to impose restrictions (e.g., "contract," creditor's "market rate") not appearing in the statutory text. *Patterson v. Shumate*, 504 U.S. 753, 754 (1992).

Respondent agrees that the concept of "present value" has a "well-recognized meaning[]" in common commercial parlance (i.e., time-value of money). (Resp. Br. 19). Petitioners contend that Congress was aware of this "well-recognized" meaning when the statute was enacted.

The dispute arises from the fact that the bankruptcy statute at § 1325(a)(5)(B)(ii) does not specify the manner in which the interest rate is to be determined. This is not the first time that federal courts have been met with the task of filling "gaps" in a comprehensive federal scheme such as the Bankruptcy Code.

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to adequate protection ends with confirmation, whereas relief under § 362(d) remains available to the Chapter 13 creditor post-confirmation. The complexity of assets (e.g., debt instruments or speculative business ventures) and variety of risks make the present value analysis as part of the "fair and equitable" standard under Chapter 11 a complex endeavor beyond the scope of consumer Chapter 13.

A federal statute may constitute a legitimate body of federal law which permits federal courts to employ federal law where the statute is silent on some key issue. John T. Cross, "Viewing Federal Jurisdiction Through the Looking Glass of Bankruptcy," 23 Seton Hall L. Rev. 530, 530-52 (1993).[2]

The "reasons which may make state law at times the appropriate federal rule," *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943), have been determined to be "singularly inappropriate" where application of state law would deal a serious blow to a federal congressional scheme, where state law is aberrant and does not provide appropriate standards for federal law, or where no overriding state interest is fulfilled by application of state law. *U.S. v. Little Lake Misere Land Co., Inc.*, 412 U.S. 580 (1973).

As explained by the Fifth Circuit in *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 793 F. 2d 1380 (5th Cir. 1986), *on reh'g*, 808 F. 2d 363 (1987) (en banc court reinstates panel opinion), *aff'd*, 484 U.S. 365 (1988):

> [T]he interest provisions of the Code and its predecessors, as interpreted by the Supreme Court for almost a century, are premised on the equitable principle that the unencumbered assets of a debtor's estate will not be used to benefit one class of creditors at the expense of another ....

793 F. 2d at 1387.

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[2] *Butner v. United States*, 440 U.S. 48 (1979), which held that property interests are created and defined by state law, is inapplicable to the present dispute, which does not involve creation or definition of a creditor's substantive property interests.

In the case of *Jones & Laughlin Steel Corp. v. Pfeiffer*, 462 U.S. 523, 547 (1983), this Court reversed the lower court's imposition of the state's "total offset" rule of discounting to present value, noting that the lower court had erroneously assumed that it was bound to apply a rule of state law as a "mandatory federal rule of decision." *Id.* at 524, 552 (*Cf*, deference afforded by the Seventh Circuit to state-law contract in the present case).

Bankruptcy courts must frequently look to other sources where the federal statute at issue does not define the applicable interest rate. Because Congress did not define "legal rate" at 11 U.S.C. § 726(a)(5), the Bankruptcy Appellate Panel in *Beguelin v. Volcano Vision, Inc.*, 220 B.R. 94 (9th Cir. BAP 1998) rejected the "state law approach," where the "legal rate" is based on state-law contract. The Court adopted the "federal law approach," applying the rate established by federal statute in the interest of equality of distribution, predictability, ease of administration, and use of federal law to decide a strictly federal issue. *Id.* at 99-100.

It has been said that "bankruptcy disputes are better characterized as *creditor-versus-creditor*.... **These are choices about distribution ..., and are not controlled by state law."** Were the debtor unable to abrogate its contracts, "some contract creditors may force performance on economically infeasible obligations. **Instead all contract partners face the same bankruptcy risk."** Elizabeth Warren, "Bankruptcy Policy," 54 Univ. Chi. L. Rev. 775, 785-86, 791, 810 (emphasis supplied).

As explained by this Court in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), the Bankruptcy Code has "reshaped debtor and creditor rights in a marked departure from state law....":

> The Code's cram down option **displaces a secured creditor's state-law right** to obtain immediate foreclosure upon a debtor's default. That change [is] ordered by federal law ....

520 U.S. at 954, 964 (emphasis supplied).

Respondent's failure to recognize this crucial state-federal law distinction causes Respondent to reach an erroneous result at odds with the bankruptcy statutes.

II. STATE-LAW CONTRACT IRRELEVANT

Remarkably, Respondent concedes that "... **section 1325(a)(5)(B)(ii) does not require** payment of the old contract rate." (Resp. Br. 38). Lenders acknowledge the Seventh Circuit's "presumption that the parties' contract rate of interest is the appropriate rate in cramdown," and conclude that "Lenders agree that the **statute does not require** any such formal presumption." (Amicus Br. 13).[3]

Neither Respondent nor Lenders grasp the significance of these admissions vis-a-vis plan confirmation. As noted by the Seventh Circuit in *Petro v. Mishler*, 276 F.3d. 375 (7th Cir. 2002):

> The Supreme Court has consistently held that Congress's use of the word 'shall' [§ 1325(a)] acts as a command to federal courts.... Furthermore, by creating a finite list of six affirmative requirements necessary for a plan's confirmation, we assume that Congress

[3] Ultimately Respondent and Lenders must admit that state contract rate is not an appropriate measure of present value – if only to circumvent the anomaly of outstanding loans at 0% APR.

> intended to exclude other requisites from being grafted onto section 1325(a).

276 F.3d at 378. *See also* S. Rep. No. 989, 95th Cong., 1st Sess. 141 (1978), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5927 (Congressional intent to fix a minimum of mandatory plan provisions).

It is thus apparent that the Seventh Circuit's imposition of a "rebuttable presumption" of contract rate was impermissible as a matter of law.[4]

Respondent is left with the untenable argument that "the contract rate and market rate are one and the same" (Resp. Br. 15) – an historically indefensible position. But Respondent needs a generic term to engraft onto § 1325(a)(5)(B)(ii), and "market rate" fits nicely with so many other concepts that Respondent found missing from the statute. (Resp. Br. 16).[5]

Respondent's arguments best demonstrate why confirmation standards cannot be controlled by generic terms like "market rate," nor permitted to take on whatever meaning a particular creditor or court chooses to ascribe.[6]

---

[4] Respondent is left with nothing in the record to suggest that the plan failed to meet the statutory prerequisites for confirmation.

[5] The concepts that a creditor be "fully compensated" and receive the "full value of its interest or claim" derived from the "fair and equitable" standard for confirmation under Chapter XI that was reintroduced at 11 U.S.C. § 1129(b)(1) but never codified under Chapter 13. "Allocation of Corporate Reorganizations Between Chapters X and XI of the Bankruptcy Act," 69 Harv. L. Rev. 352, 355 (1955); *see also, In re Murel Holding Corp.*, 75 F. 2d 941 (2d Cir. 1935).

[6] The "market rate" analysis has been said to be "so elastic that it provides no guidance to the courts." "John K. Pearson et. al., "Ending the Judicial

Even though this language was never enacted under Chapter 13, Respondent maintains that these anachronisms control Chapter 13 present value interest rates.[7] As noted by the concurring opinion in *Bank of America National Trust & Savings Associate v. 203 North LaSalle St. P'ship*, 526 U.S. 434, 462 (1999), "... it makes little sense to graft onto the Code concepts that were developed during a quite different era of bankruptcy practice." *See Hartford Underwriters Insurance Co. v. Union Planters Bank*, 530 U.S. 1, 10 (2000) [pre-Code practice is a tool of construction, *not* an extra-textual supplement to the Bankruptcy Code].

Respondent's demand for collection of exorbitant subprime interest rates at the expense of other creditors in fact represents a striking departure from the pre-Code concept of equality of distribution. Long before the advent of subprime lending, this Court in *Nichols v. U.S.*, 384 U.S. 678 (1966), recognized:

> ... the inequity that would result if, through the continuing accumulation of interest in the course of subsequent bankruptcy proceedings, obligations bearing relatively high rates of interest were permitted to absorb the assets of a bankruptcy estate whose funds were already inadequate to pay the principal of the debts owed by the estate.

384 U.S. at 683 [now codified at 11 U.S.C. § 502(b)(2)].

Snipe Hunt: The Search for the Cramdown Interest Rate, 4 Am. Bankr. Inst. L. Rev. 35, 43 (1996).

[7] *See* Resp. Br. 42-43: SCS's treatment must be "completely compensatory" in exchange for deprivation of it's "non-bankruptcy collection entitlements."

A. Contract Not "Evidence" of Discount Rate

Lenders realize the fatal error in the Seventh Circuit's "rebuttable presumption" of contract rate (Amicus Br. 13), and awkwardly attempt to bypass the Court of Appeals by "agree[ing] fully with the district court in this case ...." *Id.* Lenders are more than a little disingenuous when they contend:

> .... The debtor's post-bankruptcy credit/risk profile warranted application of the rate dictated by the sub-prime market, and the court cited 'unrebutted evidence * * * that a subprime market exists and that its rate is 21%' [Pet. App.] at 38a. 'The fact that the contract rate is 21% [was] not controlling [on the] Court's decision. * * * .' *Ibid.*

Amicus Br. 13-14.

The record makes clear that there was no "*post-bankruptcy* creditor/risk profile." Nor does the Bankruptcy Code permit the debtor to be subjected to the type of "profiling" typical of pre-petition lending markets. This illustrates an abusive technique developed by "market-rate" proponents to graft onto the statutory requirements for confirmation, thereby **limiting debtor access** – in the same manner that a lender would deny the borrower a loan.

The justification for fixing of contractual interest rates is blurred in the inefficient sub-prime market.[8] Respondent

[8] The interest rate spread between the prime and subprime markets estimated at 196 basis points (1/100 of a percentage) has been attributed to the additional cost of servicing the subprime portfolio, difference in pre-petition risk, and subprime market inefficiency. OCC Working Paper, Comptroller of the Currency, Administrator of National Banks, Washington, DC "Economic Issues in Predatory Lending," July 30, 2003.

acknowledges that a contract rate of interest as high as 20% may be charged to "compensate [the lender] for having to investigate [the borrower], dun him for collection, and cover the risk premium from default and costly litigation." (Resp. Br. 21-22).

The contract rate consists of a host of factors — none of which have any bearing whatsoever on the delay and risk of nonpayment of the $4,000.00 allowed secured claim. The parties could not have contracted for this discount factor in advance, not only because the debtors' financial status (e.g., monthly payment obligations, budget, etc.) has been completely reconfigured by the reorganization, but also because protection against delay in nonpayment of the allowed secured claim could not have been bargained for at a time when the plan repayment terms were unknown. There is simply no applicable state law.

Lenders argue that any changes in the debtor's pre-petition credit/risk profile as the debtor is reorganized are the proper subject of proceedings before the bankruptcy court, and the contract rate is "potentially an important piece of evidence" (Amicus Br. 12-13). Under Rule 401 of the Federal Rules of Evidence applicable in bankruptcy cases," '[r]elevant evidence' means evidence having any tendency to make the existence of any fact that is of consequence to the determination ... more probable or less probable than it would be without the evidence." Lenders make no attempt to suggest how the pre-

Market inefficiency results from the fact that subprime borrowers commonly purchase more expensive credit (above market rates unsupported by risk characteristics of borrowers) when less expensive credit is available. Subprime lenders too often compete with each other not by offering lower rates, but by relying on more aggressive sales techniques. Kurt Eggert, "Held Up in Due Course: Predatory Lending, Securitization and the Holder in Due Course Doctrine," 35 Creighton L. Rev. 503, 638-39 (April 2002).

petition contract rate — which measures entirely different variables — has any relevance whatsoever to the limited scope of the statutory present value calculation.[9]

Both Respondent and Lenders proceed on the assumption that the statutory rate is controlled by whatever the lender could extract from the borrower under the state-law contract. Lenders conclude that a range of "...100% - 300% ... would have the same grounding in the text of the Bankruptcy Code: none." (Amicus Br. 14). This rationale misapprehends the present value function of § 1325(a)(5)(B)(ii) to a dangerous extreme.

B. State Contract and Creditor-Debtor Specific Criteria Defeat Uniform Application of Confirmation Standards

Respondent contends that, "[l]ike 506(b), section 1325(a)(5)(B) operates to preserve for the secured creditor the 'value of its economic bargain.'" (Resp. Br. 38). This statement betrays a misunderstanding of the distinct purposes of the two sections. Section 506(b) permits oversecured claims to accrue pre-confirmation or *pendency* interest *only* up to the value of the creditor's collateral, and thus does not deplete funds otherwise payable to unsecured creditors.[10] Section

[9] Lenders attempt to do indirectly what they cannot do directly. Recognition that state contracts are not "evidence" of present value under § 1325(a)(5)(B)(ii) is critical to any effective resolution of this issue. If state contract is proper "evidence" of present value, those Circuits that have adopted contract rate without proper analysis will likely continue to do so under the guise that state contract represents "evidence" which the debtor is unable to counter; the door then remains open to introduction of debtor-creditor specific lending criteria, and the bankruptcy judges are placed in the position of unwilling loan officers.

[10] Contrary to Respondent's assertion (Resp. Br. 37), § 506(b) does not mandate interest at the contract rate for oversecured creditors, *United States*

§ 506(b) thus serves the function of defining a creditor's substantive claim. In sharp contrast, post-confirmation or *plan* interest merely preserves the status quo, and ensures that the allowed secured claim *as determined under § 506* is paid at present value.

Respondent contends that adequate protection "preserve[s] the secured party's position up to the point of confirmation," and concludes from there that Congress could not have intended to impose a substandard post-confirmation interest rate. (Resp. Br. 37). Again, Respondent misinterprets the concept of adequate protection. This Court in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), made clear that nebulous phrases such as "indubitable equivalent" and "benefit of the bargain" do not protect the undersecured creditor's pre-confirmation financial position (e.g., profit). Respondent's reliance upon the legislative history of § 361 is therefore misplaced.

Nor can Respondent conform its lender-specific approach with other confirmation sections employing identical language. Despite Respondent's concession that § 1325(a)(4) requires a similar discounting of plan payments to present value and the fact that "each allowed unsecured claim[ant]" may have a different contract rate of interest, Respondent contends that the

v. Ron Pair Enter., Inc., 489 U.S. 235 (1989), although courts have discretion to permit interest at the contract rate (consistent with pre-Code practice as to *oversecured* claims) – but only to the extent that the value of the collateral exceeds the amount of the secured claim. Under Respondent's analysis, interest at the contract rate that is no longer payable to an oversecured creditor under § 506(b) can be resumed under § 1325(a)(5)(B)(ii), thereby counteracting the limitations of § 506(b). Or interest at a contract rate of 30% could be paid under § 1325(a)(5)(B)(ii) on top of interest at the contract rate of 30% that had accrued and become a part of the claim under § 506(b).

court need only select one undefined "market rate for unsecured loans." (Resp. Br. 39). If this appears inconsistent with Respondent's analysis at § 1325(a)(5)(B)(ii), one can take comfort in Respondent's assurance that **"[t]he discounting procedure under section 1325(a)(4)... is rarely (if ever) employed"** (emphasis supplied).[11]

III. PROTECTION LIMITED TO VALUE OF COLLATERAL

Respondent and Lenders cannot accept the fact that § 1325(a)(5)(B)(ii) protects the value of the collateral – nothing more. Respondent objects that "... the secured creditor's collateral often proves inadequate to cover completely the creditor's secured claim, let alone its collection costs." (Resp. Br. 29). As stated by the Supreme Court in *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940):

> .... Safeguards were provided to protect the rights of secured creditors ... to the extent of the value of the property .... There is no constitutional claim of the creditor to more than that. And so long as that right is protected the creditor certainly is in no position to insist that doubts or ambiguities in the Act be resolved in its favor and against the debtor.

311 U.S. at 278-79.[12]

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[11] Had Respondent simply acknowledged that applying each creditor's state-law contract rate in the context of federal statutory present value does not work, § 1325(a)(4) would not have been rendered obsolete.

[12] Lenders stress that '[t]rading in claims of bankrupt concerns' is a 'multi-billion dollar market.' (Amicus Br. 6, n. 3). Presumably this is a part of the "economic value of its bargain" that debtors must shoulder under the guise of "market rate." The Code does *not* require that the lender be able to sell its bankruptcy claim on the open market. The "investment band approach" urged by Lenders (Amicus Br. 10) equates debt and equity in arriving at a "market rate of interest." A stock investor in a corporation normally is not offered a stream of payments (typical of Chapter 13), but has instead placed its capital at risk in anticipation of an increase in value of its investment over time. To argue that the Code requires a lender to obtain the return that an equity investor would require gives the lender the benefit of a stream of payments as well as the type of exaggerated returns enjoyed by investors who risk a total loss without the benefit of any collateral – another distortion of the present value concept by use of the nebulous "market rate" – again to the serious detriment of unsecured creditors.

Respondent is forever stuck in nonbankruptcy state law when it insists upon the "full economic value of its bargain" and realization of the "economic return" from its collateral. (Resp. Br. 38). Neither Respondent nor Lenders provide the slightest authority for the contention that *upon confirmation of a Chapter 13 plan*, a higher rate of interest is required to protect the subprime lender's allowed secured claim than is required to protect the prime lender's claim. For purposes of § 1325(a)(5)(B)(ii), it makes no difference whether the $4,000 allowed secured claim is held by a creditor who had the pre-petition status of a prime or subprime lender — or whether the claim originated with a debtor who was single with no established credit line.

Respondent's reliance on data (Resp. Br. 25) concerning "filed" Chapter 13 cases that fail to complete is highly misleading and unrepresentative of the *confirmed* plans that *do* complete. Other studies support a finding that a majority of plans that have been confirmed *are* successfully completed. *See, e.g.*, Marjorie L. Girth, "The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals," 65 Ind. L. J. 17, 40-42 (1989) [finding completion rate of 63% in area-wide sample of *post-confirmation* Chapter 13 cases]. Secured claimants fare quite well even in uncompleted Chapter 13s,

because allowed secured claims are much more likely to be paid than are wholly unsecured claims.[13] If a Chapter 13 debtor defaults after confirmation and *prior* to payment of the allowed secured claim, the creditor still reserves all state-court collection rights as to the collateral and collection of deficiency.[14] Assuming *in arguendo* that the overall Chapter 13 failure rate is undesirably high, and given the fact that Congress intended to promote the use of Chapter 13, it makes little sense to increase the debtors' burden by imposing excessive interest rates not mandated by the Code. Finally, if the failure rate of Chapter 13 provides a measure for interest under § 1325(a)(5)(B)(ii), *all* secured claimants would be entitled to exorbitant interest rates – not just subprime lenders – further depleting distributions to unsecured creditors.

The different rates assigned to different creditors in this case derived from the fact that the contractual interest rates were modified under § 1322(b)(2), and the fact that the plan need not pay a secured creditor's claim at present value if the creditor has accepted the plan pursuant to § 1325(a)(5)(A).

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[13] *See, e.g.*, Scott F. Norberg, "Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13," 68 Am. Bankr. Inst. L. Rev. 415, 418, 438-39 (1999) [expressing concern for shift of more dollars from unsecured to secured creditors, noting that approximately 90% of all Chapter 13 payments (excluding attorney's fees) went to secured creditors].

[14] Respondent complains that upon payment of the allowed secured claim with interest, a creditor may be required to relinquish its lien on the collateral, although this is merely a function of the fact that § 1325(a)(5)(B)(ii) protects the creditor *only* to the extent of the allowed value of the collateral. *See, e.g.*, "...Of course, the secured creditor's lien only secures the value of the collateral and to the extent property is distributed of a present value equal to the allowed amount of the creditor's secured claim the creditor's lien will have been satisfied in full..." 124 Cong. Rec. H11107 (Sept. 28, 1978); S17423 (Oct. 6, 1978).

Contrary to Respondent's attempted comparison (Resp. Br. 49), the plan's reduction of the other secured claimants' contractual interest rates resulted in *increased* distributions to unsecured claimants.

Respondent ignores the glaring inequity of distribution to unsecured claimants that underlies its position, declaring that it has no duty to "subsidize" debtors (Resp. Br. 44). Respondent fails to appreciate the fact that § 1325(b)(1) requires, upon objection, that the debtor contribute all projected disposable income for a minimum three-year term – eliminating the so-called debtor "windfall."[15] The preferential treatment of one class of creditors (e.g. subprime lenders) in fact requires other creditors to "subsidize" the inefficient subprime market.

Respondent incredulously suggests that profit rates are no higher for subprime lenders than for lenders in traditional markets (Resp. Br. 48). Most analysts agree that subprime loans are extremely profitable, as demonstrated by the influx of traditional prime lenders into the subprime market – tapping ever deeper into the borrower pool. By charging interest rates to 25%, several subprime lenders have reported profit margins of 23% to 41%. "Life After Mercury: How to Pick a 'Safe' Used-Car Lender," Financial World, May 20, 1997 at 40.[16]

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[15] "Congress frequently rewards certain individuals and groups ... with favorable rates. Debtors under Title 11 of the United States Code are among those singled out for special treatment." *In re Dingley*, 189 B.R. 264, 270, n. 6 (Bankr. N.D.N.Y. 1995). *See also Timbers, supra*, 484 U.S. at 379 ("That secured creditors do not bear one kind of reorganization cost hardly means that they bear none of them").

[16] Subprime companies also rely on a practice known as "securitization" – a process in which the lender repackages pools of loans as securities and sells them to investors. This process provides the subprime lender with a revolving source of capital with which to make new loans, and the investor

Both Respondent and Lenders contend that because the Court adopted a market-based valuation standard in *Rash*, *supra*, the Court must adopt a market-rate interest standard for computing present value – an apples and oranges comparison, similar to Respondent's contention that "market rate" equals "contract rate." The valuation determination in *Rash* was necessarily *collateral specific*, based upon the quality of particular collateral under § 506(a). But once a value is established for the collateral under § 506(a), present value under § 1325(a)(5)(B)(ii) merely preserves the value of the fixed claim amount. Further, the *Rash* valuation was premised on the fact that the debtor had *not* surrendered the property, *Id*, whereas the analysis of the Seventh Circuit below proceeded as though the debtor *has* surrendered the collateral (and that the creditor has reinvested the proceeds at a healthy profit).[17]

Respondent contends that society will be overwhelmed by the loss that must be absorbed in the event its pre-petition interest rate is adjusted. Respondent's predictions of economic doom are not well-taken.[18] Nor has Respondent cited any

– rather than the original lender – thus bears the risk of borrower default. Evan M. Gilreath, "The Entrance of Banks Into Subprime Lending: First Union and The Money Store," 3 N.C. Banking Inst. 149, 152-53 (1999).

[17] The Court in *Rash* adopted the Ninth Circuit's interpretation of fair-market value in *In re Taffi*, 96 F. 3d 1190, 1191-92 (9th Cir. 1996) (en banc), *cert. den.*, 521 U.S. 1103 (1997). 520 U.S. at 959, n.2. The Ninth Circuit in *In re Fowler*, 903 F. 2d 694, 698-99 (9th Cir. 1990), determined that the bankruptcy court did not err in use of a formula approach for determining cramdown interest (prime rate on the date of plan confirmation plus .75% risk factor; court remanded for additional fact-finding on risk). There is no inconsistency between use of a national index in conjunction with the *Rash* valuation standard.

[18] Studies on the effect of sending more debtors to Chapter 13 (as opposed to Chapter 7) estimate that the increased repayment of consumer debt would allow creditors to reduce interest rates by a trivial 0.08%- 0.43%. 37 Wake

authority evidencing an increase in Chapter 13 filings, nor a decrease in credit availability, in Circuits rejecting state-contract rates. When bankruptcy law rehabilitates debtors, it resurrects their contribution to supply and demand. Indeed, the right to a fresh start is recognized as one of the "principal productivity restoring functions" of bankruptcy law. Nicholas L. Georgakopoulos, "Bankruptcy Law for Productivity," 37 Wake Forest L. Rev. 51, 66, 94 (2002).

IV. THE FEDERAL-LAW APPROACH

Appropriate federal guidelines can thus be established for calculating present value at § 1325(a)(5)(B)(ii), and many of the alternatives that have been used in the past can be eliminated. Certain rates may be rejected because they are not sufficiently market-sensitive (i.e., not adjusted with sufficient frequency). Certain calculations are too complex and unsuited to the limited assets involved in Chapter 13 (e.g. investment band or weighted average approach of Chapter 11). The contract rate and creditor-debtor specific market rates applied by the District Court and Seventh Circuit below are improperly tied to irrelevant pre-petition state-law lending criteria.

In *Pfeifer*, *supra*, 462 U.S. at 552, this Court did not adopt a single national rate nor require 'delusive exactness.' The Court concluded that a court employing a "real interest rate" approach (for determining present value of lost earnings in suit under federal maritime statute) should not be reversed if it adopts a rate between 1-3% and explains its choice. *Id.* at 548.

Forest L. Rev., *supra* at 60, n.18, *citing* Federal Reserve Statistical Release, Consumer Credit, available at http://www.federalreserve.gov/releases/G19/hist/cc_hist_sa.html. Respondent cannot seriously contend that "full payment" is the norm outside Chapter 13 (Resp. Br. 46).

Petitioners have argued for a rate pegged to a readily accessible (national) market index as a default rate for selecting discount rates under § 1325(a)(5)(B)(ii).[19]

Outside the bankruptcy context, application of the prime rate has been adopted by various federal courts in cases where there is no statutory interest rate to compensate for both loss of use of money and risk of payment default. *See, e.g., Gorenstein Enterprises, Inc. v. Quality Care-USA, Inc.*, 874 F. 2d 431, 436-37 (7th Cir. 1989) [recommending that federal court in trademark infringement case use the prime rate for fixing prejudgment interest where there is no statutory rate because it is a "readily ascertainable figure which provides a reasonable although rough estimate of the interest necessary to compensate plaintiffs not only for the loss of use of their money but also for the risk of default"].

In other federal case contexts where the issue has arisen, a national index rate was thus adopted, and prime rate was considered sufficient to compensate *both* for delay in payment and risk of default. Given costs and other charges included in prime rate inappropriate in the bankruptcy context, use of prime rate should *not* necessitate an additional risk premium.

There is convincing authority for use of Treasury securities as a base rate. The Federal Reserve issues securities of every maturity spectrum on a regular basis. As a result, the interest rates on Treasury securities are commonly accepted as

[19] Although certain of Petitioners' amici have proposed one index for all cases, Petitioners and amici are substantially consistent in their proposed pegging of the rate to a readily accessible federal or national market independent of debtor-creditor specific characteristics. *See* accompanying Addendum for interest rates and bond yields reported by the U.S. Census Bureau in Statistical Abstract of the United States: 2002 (U.S. Department of Commerce) for periods of 1980 - 2001.

benchmark rates in the U.S. economy. Aaron J. Bell, "Making Cramdown Palatable: Post-Confirmation Interest on Secured Claims in a Chapter 11 Cramdown," 23 Willamette L. Rev. 405, 434 (1987). The appropriate Treasury instrument corresponding to the plan term could thus easily be selected as a base; because government securities are now indexed to inflation, it has been recommended that courts take judicial notice of this market in determining present value.[20]

Discounting of future damage awards to present cash value in federal tort cases does not account for any additional risk associated with distribution of a stream of payments over time. The term "risk-adjusted" discount rate has been defined as "the rate necessary to determine the present value of an uncertain … stream of income; … the risk-free rate (generally the return on short-term U.S. Treasury securities) plus a risk premium…." John Downes and Jordan Elliott Goodman, Dictionary of Finance and Investment Terms 594 (6th ed. 2003). The Treasury security rate would thus be appropriate in routine Chapter 13 cases where no additional risk factor is necessitated, or in any Chapter 13 case as a base rate.[21]

[20] One study found that only in the case of U.S. Treasury bills do data result in an average rate that, when adjusted for inflation, approximates the 2% mid-range real interest rate standard approved by *Pfeifer*, and that only in the case of Treasury bills are the average returns less than 2% above the rate of inflation. Ward S. Curran, "Present Value Analysis in Estimating Damages in Torts," 72 Conn. Bar J. 375, 399, 405 (1998).

[21] Respondent failed to demonstrate any *post-confirmation* risk to its collateral not protected by adequate protection of its fully secured lien, the *Rash* higher valuation standard, periodic wage-assignment payments, the Court's feasibility determination, and SCS's entitlement to prompt relief from stay for reinstatement of state-law collection rights had the debtors defaulted prior to full payment of the allowed secured claim with interest.

The federal-law approach adopted by the bankruptcy court must not include improper elements of compensation. It should be readily accessible, inexpensive to calculate, easily applied, and should ensure that the burden of payment does not fall disproportionately upon the debtors or other creditors.

CONCLUSION

For the foregoing reasons and those stated in Petitioners' opening brief, Petitioners respectfully request that the judgment of Court of Appeals be reversed.

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No. 1168. Money Market Interest Rates and Mortgage Rates: 1980 to 2001

[Percent per year. Annual averages of monthly data, except as indicated]

Type	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Federal funds, effective rate	13.35	8.10	8.10	5.69	3.52	3.02	4.21	5.83	5.30	5.46	5.35	4.97	6.24	3.88
Prime rate charged by banks	15.26	9.93	10.01	8.46	6.25	6.00	7.15	8.83	8.27	8.44	8.35	8.00	9.23	6.94
Discount rate [1]	11.77	7.69	6.98	5.45	3.25	3.00	3.60	5.21	5.02	5.00	4.92	4.62	5.73	3.40
Eurodollar deposits, 3-month	14.00	8.27	8.16	5.86	3.70	3.18	4.63	5.93	5.38	5.61	5.45	5.31	6.45	3.70
Large negotiable CDs:														
3-month, secondary market	13.07	8.05	8.15	5.83	3.68	3.17	4.63	5.92	5.39	5.62	5.47	5.19	6.35	3.71
6-month, secondary market	12.94	8.24	8.17	5.91	3.76	3.28	4.96	5.98	5.47	5.73	5.44	5.33	6.46	3.66
Taxable money market funds [2]	12.68	7.71	7.82	5.71	3.36	2.70	3.75	5.48	4.95	5.10	5.04	4.64	5.89	3.67
Tax-exempt money market funds [2]	(NA)	4.90	5.45	4.13	2.58	1.97	2.38	3.39	2.99	3.14	2.94	2.72	3.54	2.24
Certificates of deposit (CDs): [3]														
6-month	(NA)	8.05	7.79	5.80	3.51	2.88	3.42	4.92	4.68	4.86	4.58	4.27	5.09	3.43
1-year	(NA)	8.53	7.92	6.03	3.78	3.16	4.01	5.39	4.95	5.15	4.81	4.56	5.46	3.60
2½-year	(NA)	9.32	7.96	6.46	4.56	3.80	4.58	5.69	5.14	5.40	4.93	4.74	5.64	3.97
5-year	(NA)	9.99	8.06	7.02	5.76	4.98	5.42	6.00	6.46	5.66	5.08	4.93	5.97	4.58
U.S. Government securities:														
Secondary market: [4]														
3-month Treasury bill	11.39	7.47	7.50	5.38	3.43	3.00	4.25	5.49	5.01	5.06	4.78	4.64	5.82	3.40
6-month Treasury bill	11.32	7.65	7.46	5.44	3.54	3.12	4.64	5.56	5.08	5.18	4.83	4.75	5.90	3.34
1-year Treasury bill	10.85	7.81	7.35	5.52	3.71	3.29	5.02	5.60	5.22	5.36	4.80	4.81	5.78	3.84
Auction average: [5]														
3-month Treasury bill	11.51	7.47	7.51	5.42	3.45	3.02	4.29	5.51	5.02	5.07	4.81	4.66	5.85	3.45
Home mortgages:														
New-home mortgage yields [6]	12.70	11.60	10.05	9.32	8.24	7.20	7.49	7.87	7.80	7.71	7.07	7.04	7.52	7.00
Conventional, 15 yr. fixed [3]	(NA)	11.48	9.73	8.76	7.80	6.65	7.77	7.39	7.28	7.16	6.58	7.09	7.76	6.53
Conventional, 30 yr. fixed [3]	(NA)	11.85	9.97	9.09	8.27	7.17	8.28	7.86	7.76	7.57	6.92	7.46	8.08	7.01

NA Not available. [1] Rate for the Federal Reserve Bank of New York. [2] 12 month return for period ending December 31. Source: iMoneyNet, Inc., Westborough, MA, *Money Market Insight*, monthly, <http://www.imoneynet.com> (copyright). [3] Annual averages. Source: Bankrate, Inc., North Palm Beach, FL, *Bank Rate Monitor*, weekly (copyright). [4] Averages based on daily closing bid yields in secondary market, bank discount basis. [5] Averages computed on an issue-date basis; bank discount basis. Source: U.S. Council of Economic Advisors, *Economic Indicators*, monthly. [6] Effective rate (in the primary market) on coventional mortgages, reflecting fees and charges as well as contract rate and assumed, on the average, repayment at end of ten years. Source: U.S. Federal Housing Finance Board, *Rates & Terms on Conventional Home Mortgages, Annual Summary*.

Source: Except as noted, Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, monthly.

No. 1169. Bond Yields: 1980 to 2001

[**Percent per year**. Annual averages of daily figures, except as indicated]

Type	1980	1985	1990	1994	1995	1996	1997	1998	1999	2000	2001
U.S. Treasury, constant maturities: [1] [2]											
1-year	12.00	8.42	7.89	5.32	5.94	5.52	5.63	5.05	5.08	6.41	3.49
2-year	11.73	9.27	8.16	5.94	6.15	5.84	5.99	5.13	5.43	6.26	3.83
3-year	11.51	9.64	8.26	6.27	6.25	5.99	6.10	5.14	5.49	6.22	4.09
5-year	11.45	10.12	8.37	6.69	6.38	6.18	6.22	5.15	5.55	6.16	4.56
7-year	11.40	10.50	8.52	6.91	6.50	6.34	6.33	5.28	5.79	6.20	4.88
10-year	11.43	10.62	8.55	7.09	6.57	6.44	6.35	5.26	5.65	6.03	5.02
20-year	(NA)	(NA)	(NA)	7.47	6.95	6.83	6.69	5.72	6.20	6.23	5.63
30-year	11.27	10.79	8.61	7.37	6.88	6.71	6.61	5.58	5.87	5.94	5.49
U.S. Govt., long-term bonds [2] [3]	10.81	10.75	8.74	7.41	6.93	6.80	6.67	5.69	6.14	6.41	(NA)
State and local govt. bonds, Aaa	7.86	8.60	6.96	5.78	5.79	5.52	5.32	4.93	5.29	5.58	4.99
State and local govt. bonds, Baa	9.02	9.59	7.30	6.18	6.05	5.79	5.50	5.14	5.70	6.19	5.75
Municipal (Bond Buyer, 20 bonds)	8.55	9.11	7.27	6.19	5.95	5.76	5.52	5.09	5.43	5.71	5.15
Corporate Aaa seasoned [4]	11.94	11.37	9.32	7.96	7.59	7.37	7.26	6.53	7.05	7.62	7.08
Corporate Baa seasoned [4]	13.67	12.71	10.36	8.62	8.20	8.05	7.86	7.22	7.88	8.37	7.95
Corporate seasoned, all industries [4]	12.75	12.05	9.77	8.25	7.84	7.67	7.53	6.87	7.45	7.98	7.49

NA Not available. [1] Yields on the more actively traded issues adjusted to constant maturities by the U.S. Treasury. [2] Through September 1996, yields are based on closing bid prices quoted by at least five dealers. Beginning October 1996, yields are based on closing indicative prices quoted by secondary market participants. [3] Averages (to maturity or call) for all outstanding bonds neither due nor callable in less than 10 years, including several very low yielding "flower" bonds. [4] Source: Moody's Investors Service, New York, NY.

Source: Except as noted, Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, monthly.

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LEE M. TILL AND AMY M. TILL, PETITIONERS,

v.

SCS CREDIT CORPORATION

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Under the "cram down" provision of Chapter 13 of the Bankruptcy Code, if the holder of a secured claim objects to a proposed repayment plan under which the debtor retains the collateral securing the claim, the plan may be confirmed only if, *inter alia*, it preserves the secured creditor's lien and provides sufficient payments to the creditor over the period of repayment so that the present value of the payments is "not less than the allowed amount of [the secured] claim." 11 U.S.C. 1325(a)(5)(B)(ii). The question presented is:

How should a court determine the discount rate in assessing the present value of plan payments under 11 U.S.C. 1325(a)(5)(B)(ii)?

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In the Supreme Court of the United States

No. 02-1016

LEE M. TILL AND AMY M. TILL, PETITIONERS,

v.

SCS CREDIT CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

INTEREST OF THE UNITED STATES

This case concerns whether, when a bankruptcy plan schedules payments to a secured creditor and those payments must be discounted to present value under 11 U.S.C. 1325(a)(5)(B)(ii), the discount rate should be presumptively equal to the debtor's pre-bankruptcy contract rate. That issue is of substantial importance to the United States because it potentially affects the treatment of all secured creditors under Chapters 11, 12, and 13 of the Bankruptcy Code. The United States appears in thousands of bankruptcy proceedings each year, and a number of federal agencies—including the Department of Housing and Urban Development, the

Commerce Department's Economic Development Administration, the Small Business Administration, the Internal Revenue Service, and the Federal Deposit Insurance Corporation—appear as creditors in proceedings analogous to the case at hand. Because a bankruptcy estate's assets are typically scarce, the United States' rights are often affected by demands from secured creditors for payment based on inordinately high pre-bankruptcy contract rates.

STATEMENT

1. Chapter 13 of the Bankruptcy Code allows individuals with a regular income to adjust their debts through a repayment plan if they have less than $269,250 in unsecured debts and less than $807,750 in secured debts. See 11 U.S.C. 104(b) & note, 109(e). Repayment plans under Chapter 13 often present a workable alternative to Chapter 7 bankruptcy, which requires liquidation of all non-exempt assets. Chapter 13 plans must be judicially confirmed in order to have legal effect, and standards for confirmation are set forth in 11 U.S.C. 1325. Section 1325 requires courts to verify, *inter alia*, that "the debtor will be able to make all payments under the plan and to comply with the plan," 11 U.S.C. 1325(a)(6), and if a debtor fails to make payments as prescribed by the plan, the court may take a number of remedial steps, including ordering payments directly from the debtor's income, 11 U.S.C. 1325(c).

Section 1325(a)(5) provides that if a secured creditor objects to a repayment plan that provides for the debtor to retain the collateral securing the claim, the repayment plan cannot be confirmed unless it preserves the secured creditor's lien and provides that "the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is

not less than the allowed amount of such claim." 11 U.S.C. 1325(a)(5)(B)(ii).[1] Under that provision, bankruptcy courts must calculate the present value of the stream of future payments provided for by the plan to ensure that the present value of those payments, *i.e.*, the "property * * * distributed under the plan," is not less than the value of the creditor's secured claim. *Ibid.* In *Associates Commercial Corp.* v. *Rash*, 520 U.S. 953, 957 (1997), this Court made clear that in a case, like this, where the debtor retains the collateral, the value of the secured claim, *i.e.*, the "allowed amount of such claim," is determined by the value of the collateral as retained by the debtor, not its foreclosure value to the creditor. The Court also explained that Section 1325(a)(5) requires the debtor "to provide the creditor with payments, over the life of the plan, that will total the present value of the allowed secured claim, *i.e.*, the present value of the collateral." 520 U.S. at 957. Such present value calculations require courts to use a "discount rate" that approximates the effect of inflation and the time value of money. H.R. Rep. No. 595, 95th Cong., 1st Sess. 414 (1977); cf. *Atlantic Mutual Ins. Co.* v. *Commissioner*, 523 U.S. 382, 384 (1998) (explaining that "[a] dollar today is worth more than a dollar tomorrow") (internal quotation marks and citation omitted). The Code does not specify what "discount rate" should be used by the bankruptcy court in ensuring that the present value of the stream of payments provided for in the plan is not less than the value of the collateral.

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[1] A Chapter 13 plan can also be confirmed if the secured creditor accepts the plan, see 11 U.S.C. 1325(a)(5)(A), or if the debtor surrenders the property securing the claim to the creditor, see 11 U.S.C. 1325(a)(5)(C). See generally *Associates Commercial Corp.* v. *Rash*, 520 U.S. 953, 956-957 (1997).

Because Section 1325(a)(5) provides that secured creditors must accept future payments under the plan and may not demand immediate possession of the collateral, it is commonly referred to as a "cram down" provision. See *Rash*, 520 U.S. at 957. Similar provisions appear in Chapter 11, which concerns bankruptcy reorganization plans, and Chapter 12, which concerns debt adjustment for family farmers. See 11 U.S.C. 1129(b)(2)(A)(i)(II) and 1225(a)(5)(B)(ii). Identical or similar language regarding present value appears in the Bankruptcy Code in a number of analogous contexts. See H.R. Rep. No. 595, *supra*, at 408.[2]

2. In October 1999, petitioners Lee and Amy Till filed for bankruptcy protection, and they eventually proposed a three-year repayment plan under Chapter 13. One of petitioners' creditors, respondent SCS Credit Corporation, has a $4000 allowed secured claim that is secured by petitioners' vehicle and derives from a loan agreement dated October 1998. Pet. 3. Respondent objected to the repayment plan on the ground that its payments, when discounted to present value, were less than $4000 and thus violated Section 1325(a)(5)(B)(ii). Pet. App. 4a-5a. The plan had proposed to pay the $4000 claim plus 9.5% interest through $740 monthly payments over three years. Pet. 3. Respondent argued that the proper discount rate was 21%, because that was the interest rate charged under

[2] See 11 U.S.C. 1129(a)(7) (impaired classes of claims); 11 U.S.C. 1129(a)(9)(B)(i) and (C) (certain priority claims); 11 U.S.C. 1129(b)(2)(B)(i) and (C)(i) (unsecured claims and classes of interests); 11 U.S.C. 1225(a)(4) and (b)(1)(A) (unsecured claims); 11 U.S.C. 1228(b)(2) (discharge); 11 U.S.C. 1325(a)(4) and (b)(1)(A) (unsecured claims); 11 U.S.C. 1328(b)(2) (discharge).

petitioners' pre-bankruptcy loan and under other used car loans made by respondent. According to respondent, the plan was required to provide a 21% discount rate because, if respondent could have taken possession of the collateral, it could have funded another car loan at that rate. Pet. App. 5a.

Petitioners offered expert economic testimony indicating that the fair market price of capital and the time value of money was captured by a market "prime rate" of 8% interest, and that a 1.5% risk premium should be added to cover the risk that petitioners would not make payments as required by the plan. Pet. App. 65a-66a. Respondent offered evidence that its subprime used car loans typically carry a 21% interest rate, and that many Chapter 13 debtors fail to fulfill their plan obligations. *Id.* at 67a-74a.

The bankruptcy court rejected respondent's reliance on its own contract rates in calculating discount rates under Section 1325(a)(5). Instead, the bankruptcy court held that a 9.5% discount rate was sufficient to cover the fair market value of capital and the specific risks of nonpayment in this case. Pet. App. 43a. Respondent appealed to the United States District Court for the Southern District of Indiana. The district court reversed and held that the discount rate should be 21%, because that would have been respondent's contractual interest rate if it had sold the collateral to fund another subprime used car loan. See *id.* at 6a.

3. A divided panel of the court of appeals vacated the decision and remanded the case to the district court. The majority interpreted Section 1325(a)(5) as awarding a secured creditor "the 'indubitable equivalen[t]' of its property interest," and as requiring a discount rate to make the creditor "as well off in the reorganization as if it had been allowed to foreclose on and sell the [col-

lateral]." Pet. App. 17a-18a (internal quotation marks omitted). The majority held that a debtor's pre-bankruptcy contract rate is the presumptive minimum that serves those goals. Although it acknowledged that continuing "the old contract rate * * * under the supervision of the bankruptcy court will involve some risks that would not be incurred in a new loan * * * and also [will] result in some economies," *id.* at 20a, the majority opined that a presumption in favor of the pre-bankruptcy contract rate "will, in most cases, provide the best approximation of the proper [discount] rate," *id.* at 21a.

In dissent, Judge Rovner emphasized that compelling debtors to pay secured creditors based on "eye-popping" pre-bankruptcy contractual interest rates, such as respondent's 21% car loan, would reduce the feasibility of Chapter 13 plans and would diminish the likelihood of unsecured creditors' receiving any compensation. Pet. App. 22a. Judge Rovner noted that the courts of appeals have adopted different methods for calculating discount rates, including "the rate at which the creditor could borrow money to replace the collateral that the debtor has chosen to keep (the 'cost of funds' approach), the prime rate or a U.S. Treasury rate adjusted upward for the risk of nonpayment (the 'formula' approach), [and] the rate at which the creditor would make the same type of loan to someone like the debtor (the 'coerced loan' approach)." *Id.* at 24a.

Judge Rovner rejected the "coerced loan" or contract-rate approach adopted by the majority because it ignored the costs of disposing of the assets and of marketing and funding a new loan. Pet. App. 25a ("Requiring the debtor to pay the creditor the same rate of interest that the creditor would charge on a new loan to another consumer * * * over-compensates the

creditor, because it fails to account for the costs that the creditor would incur in funding the new loan."). Rather, Judge Rovner recognized, "[i]n this respect, the costs of funds approach comes closer to recognizing the economic consequences of the debtor's decision to keep the collateral." *Id.* at 26a. In the end, Judge Rovner concluded that Section 1325(a)(5) prescribes a formula-based discount rate that includes inflation, real interest rates, and a risk premium tailored to the plan's probability of nonpayment. See *id.* at 27a-28a ("[A] formulaic approach that employs as a base rate of interest an easily referenced rate like the prime rate or the rate on U.S. Treasury instruments, and which allows for modest enhancements to the base to account for the risk of nonpayment, is superior."). The exact amount of the plan-specific risk premium, Judge Rovner emphasized, presents "a question wisely left to the bankruptcy court, which is better situated to assess the risk of nonpayment and may adjust the rate accordingly." *Id.* at 28a.

SUMMARY OF ARGUMENT

In *Associates Commercial Corp.* v. *Rash*, 520 U.S. 953 (1997), this Court determined the proper method for ascertaining the value of collateral retained by the debtor and noted that in such circumstances, "the debtor is required to provide the creditor with payments, over the life of the plan, that will total the present value of the secured claim, *i.e.*, the present value of the collateral." *Id.* at 957 (citing 11 U.S.C. 1325(a)(5)(B)(ii)). To determine the "present value" of the payments envisioned by the plan, the bankruptcy court must employ a discount rate to reflect the time value of money. The narrow question in this case is what is the appropriate discount rate in such cases.

The Bankruptcy Code does not specify a discount rate, but the text of Section 1325(a)(5) and considerations of bankruptcy policy support the use of a discount rate that treats all creditors equitably and reflects real interest rates and inflation, rather than a presumption in favor of the pre-bankruptcy contract rate of interest, which may vary widely from creditor to creditor.

One appropriate method to calculate such a discount rate is to adjust low-risk interest rates, such as the prime rate, to account for plan-specific risks of nonpayment. That "prime-plus" formula approach determines the present value of a debtor's future payments based on the price of such payments in general financial markets, where the prime rate measures the value of low-risk capital. By including an adjustment for plan-specific default risks, a "prime-plus" formula provides a direct, fair market appraisal of the risk-adjusted present value of future payments. Such a formula approach is readily administrable; treats all creditors equally—thereby avoiding unfair disparities in cases where, as here, multiple secured creditors are parties to a single bankruptcy proceeding; and avoids the need for expert testimony regarding individual creditors' lending practices or credit status. See Pet. App. 78a.

In contrast, the "contract-rate" approach used by the court of appeals would require courts presumptively to value identical plan payments differently if those payments are made to creditors with different pre-bankruptcy contract rates. Such presumptions could be rebutted only by evidence of a specific creditor's current investment opportunities, but such opportunities are often difficult for courts to evaluate and are not directly relevant to the debtor's financial status. Furthermore, burdening debtors with often "eye-popping" contract rates, Pet. App. 22a, would under-

mine debtors' ability to pursue bankruptcy under Chapter 13, and would force many cases into liquidation under Chapter 7, to the general detriment of debtors and creditors alike.

The text of Section 1325(a)(5) supports a prime-plus formula, rather than a contract-rate, approach because it directs courts to determine the value of a debtor's proposed payments, not profits a creditor could hypothetically earn if it were allowed to liquidate and reinvest the collateral. Under this Court's decision in *Rash*, the value of a secured asset in a Chapter 13 cram down turns on the asset's actual value *to the debtor*, not its counterfactual foreclosure value *to the creditor*. See 520 U.S. at 962. Likewise, under Section 1325(a)(5), the value of plan payments depends on their estimated worth in financial markets, not on each creditor's revenues after a counterfactual foreclosure and new loan.

Standard discount rate calculations for future cash payments rest on the general time value of money and risks of nonpayment by the debtor. The court of appeals erred because it looked exclusively to the creditor's alleged opportunity costs, using evidence of respondent's subprime car loans. Because subprime car loans, like high-yield "junk bonds," are priced to include significant risk premiums, and may also include costs of marketing new loans and substantial profit margins, the prime rate is a better estimate of the time value of money and is thus a more reliable starting point for calculating a fair discount rate.

The court of appeals also erred by ignoring the bankruptcy court's case-specific determination, based on an examination of petitioners' financial status and expert testimony, that the plan's nonpayment risks required a 1.5% adjustment above the prime rate. That risk assessment is not disputed in this case, and it incor-

porates statutory safeguards that ensure that plan payments are made, including a bankruptcy court's duty to assess the plan's feasibility (11 U.S.C. 1325(a)(6)), the trustee's responsibility to advise and oversee administration of the estate (11 U.S.C. 1302 and 1326(a)(2)), limitations on the debtor's ability to incur new credit obligations (11 U.S.C. 1305(c)), and the court's authority to order payments directly from the debtor's income (11 U.S.C. 1325(c)). Such judicial oversight may often yield greater creditor protection than subprime loans in ordinary commercial markets.

ARGUMENT

THE APPROPRIATE DISCOUNT RATE IN ASSESSING THE VALUE OF PAYMENTS UNDER A PLAN SHOULD PRIMARILY REFLECT THE TIME VALUE OF MONEY, NOT THE PARTICULAR CREDITORS' PROFITS UNDER PRE-BANKRUPTCY CONTRACTS

Chapter 13's "cram down" provision states that where a secured creditor objects to the debtor's proposed plan, the debtor may choose to surrender the collateral securing the claim or may retain such collateral if the value of the stream of payments envisioned by the plan is "not less than the allowed amount of [the secured] claim." 11 U.S.C. 1325(a)(5)(B)(ii). This Court stated in *Rash* that in assessing the value of the payments under the plan to ensure that they equal or exceed the value of collateral, courts must evaluate the "present value" of the payments "over the life of the plan." 520 U.S. at 957. This case concerns the proper discount rate that courts should employ in making that present value calculation.

Although the Bankruptcy Code does not explicitly address how to select the appropriate discount rate, this Court in *Rash* appeared to focus on ensuring that

the present value was discounted by the time value of money so as to reflect the value of payments made "over the life of the plan." 520 U.S. at 962.[3] That focus on adjusting for the time value of money is consistent with the legislative history of Section 1325(a)(5) and similar present value provisions. See H.R. Rep. No. 595, *supra*, at 413 (recognizing that identical language in Chapter 11's cram down provision is intended to recognize the "time-value of money"); cf. *Chesapeake & Ohio Ry.* v. *Kelly*, 241 U.S. 485, 491 (1916) ("in computing the damages recoverable for the deprivation of future benefits, the principle of limiting the recovery to compensation requires that adequate allowance be made, according to circumstances, for the earning power of money"). At a minimum, therefore, the appropriate discount rate must reflect the real interest rate and account for inflation.[4]

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[3] That the Court in *Rash* viewed "present value" as simply rejecting an adjustment for the time value of money is reinforced by the Court's description of the original proposed plan in that case as providing for payments, "over 58 months," in "an amount equal to the present value of the truck." 520 U.S. at 957. The total proposed payments in that case reflected principal in the amount of the alleged value of the truck, plus interest at nine percent. See *In re Rash*, 31 F.3d 325, 327 (5th Cir. 1994).

[4] The text of Section 1325 is consistent with the view that the appropriate discount rate should reflect only the time value of money and not any risk premium. Section 1325(a)(5) does not specify the discount rate that should be employed in assessing the value of a stream of payments or whether a separate adjustment for risk should be made. That silence may be consistent with a view that the "value" determination mandated by Section 1325(a)(5) (and Section 1325(a)(4)) requires only a mechanical adjustment for the time value of money, rather than a more complicated adjustment for risk. Likewise, Section 1325(a)(6) requires the bankruptcy court to verify that "the debtor will be

In addition, some courts of appeals have included an adjustment for the risk of extending credit based on the bankruptcy court's assessment of the debtor's financial condition. This approach builds on an interest rate, like the prime rate, that reflects real interest, inflation, and some risk premium, and then adjusts it for the case-specific risks of default. It reflects the recognition that, although the bankruptcy court has determined that "the debtor will be able to make all payments under the plan" as a condition of plan confirmation, 11 U.S.C. 1325(a)(6), there is still a practical risk that the debtor will default on its payments. One of the virtues of this approach is that it focuses the court's discretion on an issue—the case-specific risk of nonpayment—that the bankruptcy court is uniquely competent to make.[5]

Other courts, however, have held that the discount rate is presumptively equal to the pre-bankruptcy contract's interest rate. Such a "contract-rate" approach misconstrues the language and function of

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able to make all payments under the plan and comply with the plan." Such a determination would be consistent with an assessment of value that reflected the time value of money, but not the risk that "the debtor will [*not*] be able to make all payments under the plan." This preference for a mechanical adjustment for the time value of money rather than a complicated adjustment would also be consistent with this Court's warning in another context that disputes over the proper discount rate should not convert "[t]he average accident trial * * * into a graduate seminar on economic forecasting." *Jones & Laughlin Steel Corp.* v. *Pfeifer*, 462 U.S. 523, 548 (1983) (citation omitted).

[5] Some support for this approach may be found in this Court's observation in *Rash* that one reason for adopting the replacement value as the measure of the collateral was that "[a]djustments in the interest rate" may not be enough to account for case-specific risks of nonpayment and depreciation of collateral. 520 U.S. at 962-963.

Section 1325(a)(5), creates disparities among creditors, and imposes undue administrative burdens on bankruptcy litigation.

A. The Court Of Appeals' Contract-Rate Approach Is Inconsistent With The Text And Purposes Of Section 1325(a)(5), Especially As Interpreted By This Court In *Rash*

The court of appeals declared that bankruptcy courts should, absent contrary evidence, accept a creditor's pre-bankruptcy contract rate as proof of counterfactual profits that it would have earned had it foreclosed and used the proceeds to fund a new loan. See Pet. App. 17a-22a. Such an approach is inconsistent with the text and purposes of the Bankruptcy Code. As an initial matter, Congress, in 11 U.S.C. 1322, has generally authorized the wholesale modification of the contractual rights of all creditors, including by permitting courts to "modify the rights of holders of secured claims." 11 U.S.C. 1322(b)(2). With the exception of home mortgages, which Congress expressly exempted from modification in most cases, see 11 U.S.C. 1322(b)(2) and (c)(2), the authority to modify contractual rights includes the power to alter contractual interest rates. See 1 Keith M. Lundin, *Chapter 13 Bankruptcy* § 104.1, at 104-1 (3d ed. 2002) (Section 1322(b)(2) grants courts the "very significant power * * * to change contract terms by altering interest rates and monthly payments, by changing the length of the repayment period, by changing the total amount to be repaid and by modifying acceleration and default provisions.").

The scope of the Chapter 13 authority to modify contractual rights is evidenced in this case. Virtually every term of respondent's loan was modified under the repayment plan—from the amount to be repaid to the

length of the repayment period—and respondent has not challenged those modifications. As the exemption for home mortgages contained in Section 1322(b)(2) demonstrates, if Congress had wanted to exempt contractual interest rates from modification under Chapter 13 repayment plans, it knew how to do so.

Instead, Congress, in Section 1325(a)(5), without specifying any particular discount rate or even outlining a methodology for determining a discount rate, merely provided that "the value, as of the effective date of the plan, of property to be distributed under the plan on account of [an allowed secured claim]" should be "not less than the allowed amount of such claim." 11 U.S.C. 1325(a)(5)(B)(ii). Nothing in that language suggests that in a cram down proceeding the present value of the stream of payments envisioned by the plan should turn on the pre-bankruptcy interest rate specified in a superseded contract or by the hypothetical profits that the creditor could have earned if it could have foreclosed on the collateral and funded a new loan.[6]

This Court rejected similar creditor-specific valuation methods in *Rash*. There, the question was how to value a secured claim for purposes of Chapter 13's cram down provision. See 11 U.S.C. 506(a). The court of appeals had held that the value of a secured claim's collateral should be equal to the collateral's "foreclosure value"—*i.e.*, what the particular creditor would have earned if it had repossessed and liquidated the collateral. This Court disagreed, refusing to determine the collateral's value based on creditor-specific opportunity costs where the debtor, not the creditor, retains the collateral. Instead, the Court employed a "replacement value" standard based on normal market prices and the collateral's actual value to the debtor. The Court explained that a secured asset's value turns on "the creditor's interest in the collateral in light of the proposed [repayment plan] reality: no foreclosure sale * * *. That actual use, rather than a foreclosure sale that will not take place, is the proper guide." 520 U.S. at 963 (internal quotation marks and citations omitted).

That the replacement value of the collateral may generally provide the secured creditor with more than it would have received had it foreclosed on the collateral and reinvested the proceeds is of no moment, the Court explained, because Chapter 13 expressly ties the value of the creditor's claim to the "proposed disposition or use" of the collateral. 520 U.S. at 962 (quoting 11 U.S.C. 506(a)). Accordingly, the value of the creditor's claim "turns on the alternative the debtor chooses —in one case the collateral will be surrendered to the creditor, and in the other, the collateral will be retained and used by the debtor." *Ibid.* Thus, the Court concluded, the text of the Bankruptcy Code governing Chapter 13 requires that "[f]rom the creditor's perspective as well as the debtor's, surrender and retention [of collateral] are not equivalent acts." *Ibid.*

By analogy, in determining the present value of a debtor's plan payments, the income that a specific creditor could have earned under the contract in the absence of Chapter 13 proceedings or in the counterfactual event that the proceeds of a foreclosure sale were available for reinvestment is beside the point. The statutory task is to appraise the value of the plan's

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[6] That Section 1325(a)(5) does not support the contract-rate approach adopted below is further evidenced by the fact that Congress has rejected attempts to amend Section 1325 to require that approach. See H.R. 1085, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 1169, 98th Cong., 1st Sess. § 19(2)(A) (1983); H.R. 4786, 97th Cong., 1st Sess. § 19(2)(A) (1981).

future payments, and that appraisal—like the valuation of the underlying claim that was at issue in *Rash*—need not be contingent on what a particular creditor might have done if it had been allowed to liquidate the collateral.[7]

The court of appeals reached a contrary conclusion because it misconstrued the structure of Section 1325. Where a secured creditor objects to a repayment plan,

[7] One notable difference between *Rash* and this case is that—unlike the market for automobiles that provided the basis for the replacement-value calculation in *Rash*—there is no directly analogous "market" for discount rates that reflects the unique mix of transaction costs, risks, and protections that exist in bankruptcy. As one court explained, "it is difficult to arrive at a current market rate of interest for a hypothetical new loan when there is no market for the loan proposed, no equity in the property and limited opportunity on the part of the debtor to obtain financing outside of the Bankruptcy Code framework." *In re Jordan*, 130 B.R. 185, 189 (Bankr. D.N.J. 1991), overruled by *GMAC* v. *Jones*, 999 F.2d 63 (3d Cir. 1993); see *In re Ivey*, 147 B.R. 109, 118 (M.D.N.C. 1992) (describing attempts to determine the precise rate on a hypothetical loan as "impossible and simply a waste of time") (citation omitted); *In re Computer Optics, Inc.*, 126 B.R. 664, 672 (Bankr. D.N.H. 1991) (noting that any rate arrived at by comparison to a hypothetical market would be highly speculative). Particularly given the absence of any directly analogous market, the prime-plus approach represents the most equitable, accurate, and efficient method for determining Chapter 13 cram down discount rates. Moreover, any suggestion that the replacement value concept supports adoption of subprime rates in this context because no lender in any hypothetical market would make a loan to a Chapter 13 debtor for less than such a near usurious rate would be misguided. Even if the assumption underlying that argument were true (which is questionable), it would not support adopting a presumption in favor of the pre-bankruptcy contract rate (which may or may not be a subprime rate), although it may suggest that the risk factor element under a prime-plus approach may need to be larger than some courts have suggested.

Section 1325 nonetheless allows approval of the plan if the debtor surrenders the collateral, or if the present value over the life of the plan of the payments envisioned by the plan is no less than the value of the collateral. The court of appeals—like a number of courts of appeals that adopted the "contract-rate" or "coerced loan" approach prior to this Court's decision in *Rash*—erred by assuming that "Congress intended that each of these options [*i.e.*, foreclosure or cram down] afford the secured [creditor] somewhat equivalent protection," Pet. App. 11a, and by inferring an unstated "statutory directive that the creditor be placed in the same position as * * * if it had been allowed to * * * repossess[] the collateral," *id.* at 19a. Cf. *GMAC* v. *Jones*, 999 F.2d 63, 68 (3d Cir. 1993) (stating goal of discount rate calculation as placing creditor "in approximately the same position it would have occupied had it been able simply to repossess the collateral at the time of the bankruptcy"); *United Carolina Bank* v. *Hall*, 993 F.2d 1126, 1130 (4th Cir. 1993) (indicating purpose of discount rate calculation "is to place the secured creditor in the same economic position as if the debtor had surrendered the collateral to the secured creditor").[8]

After *Rash*, however, it is clear that the Code does not ensure parity between what a creditor receives in foreclosure and what a creditor receives when the debtor retains the collateral. If a debtor surrenders the

[8] Indeed, of the court of appeals decisions to adopt the contract-rate approach, only this case and the Fifth Circuit's decision in *In re Smithwick*, 121 F.3d 211, 213-215 (1997), cert. denied, 523 U.S. 1074 (1998), were decided after this Court's ruling in *Rash*, and both of those decisions rely on pre-*Rash* cases with little or no discussion of *Rash*'s impact.

collateral, the creditor effectively obtains the asset's "foreclosure value," and that foreclosure value constitutes a creditor's opportunity cost under a Section 1325(a)(5) cram down. If the debtor retains the collateral and invokes the cram down provision, however, the creditor receives a bankruptcy claim equal to the asset's "replacement value" in the marketplace, which often may be significantly larger than the creditor-specific foreclosure value. See *Rash*, 520 U.S. at 957-960. Just as Congress did not ensure a consistent value for the collateral without regard to whether the debtor retained the property, it did not prescribe that creditors should earn equal rates of return through foreclosure and plan payments under 11 U.S.C. 1325(a)(5). In both contexts, the Bankruptcy Code gives the option to the debtor and focuses on the actual value of the asset in light of the debtor's choice, not on its value if the debtor had made the opposite choice.[9]

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[9] The court of appeals also indicated that Section 1325(a)(5) entitled a secured creditor to the "'indubitable equivalence' of its property interest, which means a stream of payments including interest that adds up to the present value of its claim." Pet. App. 17a (citation omitted). The statutory term "indubitable equivalent," however, appears only in two provisions of the Bankruptcy Code, neither of which applies here. See 11 U.S.C. 361(3) (dealing with automatic stay and trustees' authority to sell estate property or obtain credit); 11 U.S.C. 1129(b)(2)(A)(iii) (prescribing an "indubitable equivalent" standard as an alternative to cram down in Chapter 11 proceedings). Moreover, even if secured creditors did deserve an "indubitable equivalence" under Chapter 13, it would be only an equivalence between the plan's proposed payments and *the creditor's allowed secured claim*. Disputes over present value and discount rates concern how courts should calculate that equivalence. Language quoted from Sections 361(3) and 1129(b)(2)(A)(i) does not in any way answer that question.

B. The Prime-Plus Formula Approach, Unlike The Contract-Rate Approach, Comports With The Bankruptcy Code's Fundamental Goal Of Treating Similar Classes Of Creditors Equally

1. A prime-plus formula is appropriate for calculating discount rates in bankruptcy proceedings because it treats all secured creditors equally based on the value of their claims. See *Begier* v. *IRS*, 496 U.S. 53, 58 (1990) ("Equality of distribution among creditors is a central policy of the Bankruptcy Code."); see also *Union Bank* v. *Wolas*, 502 U.S. 151, 161 (1991) (describing "equality of distribution among creditors" as "the prime bankruptcy policy"). Under a prime-plus formula, two secured creditors with the same payment streams for collateral of equal value would be subject to the same discount rate and necessarily would receive comparable treatment under the plan. Under a contract-rate approach, however, the same two creditors might be subject to widely different discount rates even though they would confront equal plan-specific default risks and equal costs due to the time value of money, simply because their contract rates reflect contracts created at different times, under different inflation rates, or when the debtor occupied a different financial position. Such anomalies only increase for secured creditors that change their lending rate or line of business or that sell their claims to other entities. Cf. *United Carolina Bank* v. *Hall*, 993 F.2d 1126, 1131 (4th Cir. 1993) (holding that discount rates change when secured claims are purchased by an entity with business opportunities different from the original claimholder's).[10]

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[10] Although no court of appeals has yet addressed the issue, the logic of the court of appeals' contract-rate approach would apply

Nothing in the Bankruptcy Code suggests that such a contract-specific and creditor-specific approach is either required or appropriate, and the costs associated with such a standard are substantial. Such creditor-specific approaches to determining discount rates "are nightmares of logic and application." 2 Keith M. Lundin, *Chapter 13 Bankruptcy* § 112.1, at 112-8 (3d ed. 2002); see *ibid.* ("If present value varies from creditor to creditor depending on facts specific to each creditor's financial condition, management and lending practices, then the interest rate at confirmation in a Chapter 13 case will be different with respect to every claim. * * * It is not imaginable that Congress intended 'value, as of the effective date of the plan' to mean that inefficient, poorly managed lenders get higher interest rates than well managed, better capitalized lenders.").[11]

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equally to unsecured creditors as well. Under 11 U.S.C. 1325(a)(4), for example, Congress used language identical to Section 1325(a)(5) in requiring that unsecured creditors receive a "value, as of the effective date of the plan, of property to be distributed under the plan" at least equal to what they would receive through liquidation under Chapter 7. Similar provisions also exist under Chapters 11 and 12. See 11 U.S.C. 1129(a)(7)(A)(ii), 1225(a)(4). Thus, the principles underlying the contract-rate method imply that *every* creditor in proceedings under Chapters 11, 12, or 13 could demand a discount rate specific to its opportunity costs for payments provided to it under a single debtor's plan, and those discount rates would presumptively depend on the interest rate in pre-bankruptcy contracts. See 8 *Collier on Bankruptcy* ¶ 1325.06[3][b], at 1325-36 (Alan N. Resnick & Henry J. Sommer, eds., 15th ed. rev. 2003).

[11] The Third Circuit in *GMAC* v. *Jones*, 999 F.2d at 70 n.10, sought to bolster its contract-rate analysis by citing the legislative history of 11 U.S.C. 502(b). Section 502(b)(2), however, merely states that claims for unmatured principal are allowed in bankruptcy, while claims for unmatured interest are disallowed. It has nothing to do with present value calculations under Section 1325,

The principle that a particular creditor's high pre-bankruptcy contractual interest rate should not be allowed to absorb a debtor's estate to the detriment of other similarly situated creditors has long been a part of bankruptcy law. Before the 1984 amendments to the Bankruptcy Code codified the disallowance of claims for unmatured interest, see 11 U.S.C. 502(b)(2), this Court had long disallowed such claims, in significant part to avoid the "unfairness as between competing creditors" resulting from the fact that some creditors "carry a

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as a careful reading of the House Report in question makes clear. The Report notes that the Code disallows as unmatured a claim for "any portion of prepaid interest [under a contract] that represents an original discounting of the claim, yet that would not have been earned on the date of bankruptcy," and it states that an "unarticulated reason" for that result is that there is an "irrebutable presumption that the discounting rate and the contractual interest rate * * * are equivalent." H.R. Rep. No. 595, *supra*, at 352, 353. In essence, it observes (albeit somewhat confusingly) that Section 502's disallowance of unmatured interest, at least in the narrow context of an original discount of interest provided for by a contract, is mathematically equivalent to a hypothetical statute that allowed such interest but discounted it using the contractual interest rate. Nothing in that language should be read as propounding a general methodology for determining present value. See *Dunn* v. *CFTC*, 519 U.S. 465, 478 (1997) (describing similar statements as "legislative dicta"). That is particularly true given that the legislative history of the Bankruptcy Code provisions that do concern present value calculations indicates that there is no automatic or universal presumption that contractual interest rates and discount rates are equal. See, *e.g.*, H.R. Rep. No. 595, *supra*, at 414-415 (describing present value calculation under Chapter 11's cram down provision without reference to the pre-bankruptcy contract rate). Moreover, neither the Third Circuit nor any other circuit has adopted an "irrebutable presumption" favoring the contract rate, as its misguided reliance on Section 502(b)'s legislative history would suggest. *E.g.*, *Jones*, 999 F.2d at 70-71. Nor has respondent advocated such a mechanical rule. Br. in Opp. 4.

high [interest] rate and some a low [interest] rate." *Bruning* v. *United States*, 376 U.S. 358, 362 & n.4 (1964) (quoting *American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Ry.*, 233 U.S. 261, 266 (1914)); see *Nicholas* v. *United States*, 384 U.S. 678, 683-84 (1966) ("inequity * * * would result if, through the continuing accumulation of interest * * * [during] bankruptcy proceedings, obligations bearing relatively high rates of interest were permitted to absorb the assets of a bankrupt estate whose funds were already inadequate to pay the principal of the debts owed by the estate"). Although the question of the proper discount rate under Section 1325(a)(5) is distinct, those same equitable considerations counsel strongly against a creditor-specific contract-rate approach.

In addition, by requiring courts to compare the value of a creditor's hypothetical investments based on the counterfactual assumption that the creditor foreclosed on the collateral and used the proceeds to fund a new loan, the contract-rate approach would result in substantial and needless administrative difficulties. In contrast, a prime-plus formula provides a broadly applicable method of calculating discount rates that is administrable in bankruptcy proceedings, where litigation costs can be significant, because it turns on readily available market data and risks of plan nonpayment that bankruptcy courts are inherently well-situated to assess. See 11 U.S.C. 1325(a)(6).

2. As the foregoing suggests, simply reconceptualizing Section 1325(a)(5)'s cram down provision as a "coerced loan" (Pet. App. 17a), is misguided, and in any event, does not answer how a court should determine the discount rate. In the first place, viewing the cram down provision as a coerced loan is based on the counterfactual assumption that the creditor is, or

should be, in the same position as if the collateral had been liquidated and a new loan initiated. But *Rash* rejects any notion that the Code guarantees the creditor the same rights when the debtor retains the property as when the collateral is liquidated.

The court of appeals' decision is also flawed because, even if respondent had liquidated the collateral to issue another subprime car loan, the 21% contract rate of that hypothetical loan would have to be adjusted, for purposes of Section 1325(a)(5), to account for potentially significant differences in the creditor's costs and the debtor's risk of default. Unlike its other subprime loans, the so-called "coerced loan" respondent extended to petitioner under the repayment plan did not require respondent to incur traditional marketing and other transaction costs that are reflected in its subprime rate. As a leading bankruptcy treatise explains, "[t]o include [such costs] in the present value discount rate gives the holder of an allowed secured claim more than the equivalent of immediate payment of that claim in full." 8 *Collier on Bankruptcy* ¶ 1325.06[3][b], at 1325-36 (Alan N. Resnick & Henry J. Sommer, eds., 15th ed. rev. 2003); see *id.* at 1325-35 to 1325-36 (concluding that "it is rarely appropriate to select the rate charged to the debtor in the original transaction as the present value discount rate"); see Pet. App. 29a-30a.

In any event, the coerced loan analogy does not dictate a particular discount rate. Indeed, the court of appeals acknowledged as much in its discussion of *Koopmans* v. *Farm Credit Services of Mid-America, ACA*, 102 F.3d 874 (7th Cir. 1996). See Pet. App. 19a ("It is clear that *Koopmans* * * * adopted the coerced loan method, *the specific application of which led to the prime-plus rate.*") (emphasis added); cf. *id.* at 31a-32a (noting *Koopmans* "endorses the coerced loan ap-

proach," but "affirm[ed] the bankruptcy court's decision to use the prime rate with an appropriate risk enhancement"); *In re Kidd*, 315 F.3d 671, 672, 675-678 (6th Cir. 2003) (adopting "coerced loan" formulation, but rejecting an "automatic" preference for either the contract rate or a hypothetical rate "that would apply in the nonexistent 'market' that encompasses the factors prevalent in the bankruptcy setting," and instead affirming the district court's adoption of a "conventional" car loan rate of 10.3%). A prime-plus formula reflects the discount rate appropriate at the time of the so-called "coerced loan" based on the bankruptcy court's assessment of the risks of default, while a contract-rate approach would presumptively set the discount rate based on an interest rate agreed to at a different time under starkly different circumstances. The peculiarity of the contract-rate approach is that different levels of compensation are prescribed for different secured creditors, even if they make identical "coerced loans" to the same debtor, with identical risks of default.

The "coerced loan" metaphor also overlooks the fact that other creditors' interests are often affected in ongoing bankruptcy proceedings. For typical cases, where assets are scarce, to favor the interests of one secured creditor implicitly disfavors the interests of other creditors. For unsecured creditors especially, the contract-rate approach would result in fewer assets for the payment of claims, because it significantly increases payments for high-interest secured creditors.

3. To require full satisfaction of pre-bankruptcy contracts under Chapter 13 repayment plans—even where contractual rates far exceed the risk-adjusted market value of capital—would hinder courts' ability to confirm Chapter 13 plans and debtors' ability to complete their payments under those plans. Pet. App. 22a;

H.R. Rep. No. 595, *supra*, at 117. The burdens of the contract-rate approach thus fall on debtors and creditors alike, because where Chapter 13 bankruptcy proceedings fail, debtors may be forced to enter liquidation-based bankruptcy under Chapter 7.

In enacting the Bankruptcy Reform Act of 1978, Congress made clear its preference for the flexible provisions of Chapter 13 bankruptcy relative to Chapter 7 liquidation. Chapter 13 debtors benefit by retaining possession of their assets, and Chapter 13 creditors benefit because they may seek compensation from a creditor's income, such that in most cases "losses will be significantly less" than under Chapter 7. H.R. Rep. No. 595, *supra*, at 118 ("[U]se of the bankruptcy law should be a last resort [and] if it is used, debtors should attempt repayment under Chapter 13."); *id.* at 124. Congress did not express this preference for Chapter 13 proceedings and give bankruptcy judges the power to override contract terms, including interest rates, only to saddle debtors emerging from Chapter 13 with high contract rates of interest that may force debtors into a Chapter 7 liquidation. Instead, consistent with the Bankruptcy Code's safeguards for both debtors and creditors, Section 1325(a)(5) is properly read to calculate discount rates using a prime-plus formula, which primarily focuses on the time value of money, grants secured creditors no more than a risk-adjusted market interest rate, and treats all secured creditors equally.

C. The Court Of Appeals' Reasons For Rejecting The Prime-Plus Formula Are Unpersuasive

The court of appeals rejected the bankruptcy court's prime-plus approach on the grounds that it inadequately protected respondent from (1) risks that petitioners might default under the plan, (2) risks that

the collateral would depreciate, and (3) costs of maintaining the loan. Pet. App. 16a. Each of those concerns is misplaced.

First, with respect to default, the court of appeals overlooked the fact that the bankruptcy court must verify that the plan payments "will" in fact be made before approving the plan. 11 U.S.C. 1325(a)(6); see n.4, *supra*. While many Chapter 13 plans do fail, a concern for the risk of default is properly reflected in subsection (a)(6), and to the extent that concern for default prompts courts to apply "eye-popping" contract-based discount rates under subsection (a)(5), the concern may become a self-fulfilling prophecy.

The court of appeals' concern also overlooks the fact that the prime-plus approach explicitly adjusts the discount rate to account for nonpayment risks under the plan and that bankruptcy courts are particularly well-positioned to evaluate such nonpayment risks. Here, the bankruptcy court examined petitioners' financial status and expert economic testimony and concluded that the plan-specific risk of nonpayment required a 1.5% adjustment above the prime rate. That risk assessment is undisputed as a factual finding.[12]

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[12] The bankruptcy courts should presumably have substantial flexibility in making a risk adjustment when the extent of the adjustment is disputed. Cf. *Rash*, 520 U.S. at 965 n.6 (noting bankruptcy courts' flexibility in administering Chapter 13 proceedings). That is the approach this Court has taken in other contexts involving present value calculations. See, *e.g.*, *Jones & Laughlin Steel*, 462 U.S. at 546 (declining to adopt "one of the many rules that have been proposed and establish it for all time as the exclusive method in all federal trials for calculating an award for lost earnings in an inflationary economy"). In some cases, a debtor's risk of nonpayment could be substantial. On the other hand, at least one commentator has opined that the risk-factor element under the prime-plus approach "need not be large," because "the creditor's

In addition to the bankruptcy court's feasability determination under Section 1325(a)(6), Chapter 13 contains a number of other safeguards for creditors that are reflected in the bankruptcy court's risk assessment, including a requirement that the trustee advise and oversee administration of the estate (11 U.S.C. 1302 and 1326(a)(2)), restrictions on the debtor's ability to incur new credit obligations (11 U.S.C. 1305(c)), and the authority of the bankruptcy court to order payments to be deducted directly from the debtor's income (11 U.S.C. 1325(c)). While such oversight by bankruptcy courts and trustees may not eliminate the risk of nonpayment, it may often yield greater protection, at lower costs to creditors, than would be available for subprime loans in normal commercial markets.

Second, this Court considered in *Rash* the risks of depreciating collateral and observed, contrary to the court of appeals' reasoning, that Congress *expected* secured creditors to bear some of those costs. 520 U.S. at 962-963. In any event, the contract-rate method depends primarily on pre-bankruptcy contracts and current investment opportunities, rather than pegging discount rates to specific concerns about post-bankruptcy depreciation. Accordingly, under the contract-rate method, creditors with high contract rates presumptively would receive larger payments under a cram down than creditors with low contract rates, even

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main protections against risk" are those expressly provided for in the Bankruptcy Code and because subprime lending rates may be primarily the result of "high costs of marketing, high transaction costs relative to the amount of the debt, and consumers' failure to effectively shop for lower rates due to various imperfections in the market." 8 *Collier on Bankruptcy*, *supra*, ¶ 1325.06[3][b], at 1325-37.

if the latter's collateral suffered greater risk of post-bankruptcy depreciation.

Third, the court of appeals failed to explain, and the record does not indicate, any significant costs to respondent of "continuing to service the loan." Pet. App. 16a, 20a n.5. On the contrary, as the court of appeals acknowledged, a creditor may reap substantial administrative "economies" in bankruptcy as compared with ordinary commercial loans. *Id.* at 20a. For example, the bankruptcy court takes primary responsibility for evaluating the plan's initial feasibility (11 U.S.C. 1325(a)(6)), and the trustee—not the creditor—monitors, collects, and distributes plan payments, while also more generally endeavoring to protect the estate from abuse (11 U.S.C. 1302 and 1326(a)(2)). There is no indication that Congress sought to protect secured creditors from any residual costs that remain, much less that Congress implicitly did so by rendering discount rates under Section 1325(a)(5) equal to a creditor's pre-bankruptcy contract rates.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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LEE M. TILL AND AMY M. TILL,

Petitioners,

v.

SCS CREDIT CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS, THE NATIONAL CONSUMER LAW CENTER, AND THE CONSUMER FEDERATION OF AMERICA AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST OF *AMICI CURIAE* [1]

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 1,200 consumer bankruptcy attorneys nationwide. Member attorneys and their law firms represent debtors in an estimated 300,000 bankruptcy cases filed each year. NACBA is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. NACBA has filed *amicus curiae* briefs in various appellate courts seeking to protect the rights of consumer bankruptcy debtors, including briefs filed in this Court. *See, e.g., Kawaauhau v. Geiger*, 118 S.Ct. 974 (1998).

The NACBA membership has a vital interest in the outcome of this appeal. NACBA members represent primarily individual low- and moderate-income wage-earners. Many of the bankruptcy cases filed by such wage-earners involve secured debts in chapter 13 bankruptcies. Since the advent of the coerced loan approach, and specifically the presumptive contract rate approach, debtors have been forced to pay much more to secured creditors through their bankruptcies. This harms debtors by raising their chapter 13 plan payments, making their

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[1] All parties to this case have consented to the filing of this brief, and letters indicating consent have been submitted contemporaneously. No counsel for any party authored this brief in whole or in part, and no person or entity other than *amici curiae*, their counsel, or their members made a monetary contribution to the preparation of this brief.

bankruptcies much less feasible, and results in lower payments to other creditors.

The National Consumer Law Center, Inc. (NCLC), is a non-profit corporation established in 1969 to carry out research, education, and litigation regarding significant consumer matters. One of NCLC's primary objectives is to assist attorneys in representing the interests of their low-income and elderly clients in the area of consumer and bankruptcy law. A major focus of NCLC's work has been to increase public awareness of, and to advocate protections against, high-cost loans and other forms of abusive credit extended to low-income consumers. NCLC publishes *The Cost of Credit: Regulation and Legal Challenges* (2d ed. 2000 & Supp. 2003), *Truth in Lending* (4th ed. 1999 & Supp. 2002), and *Consumer Bankruptcy Law and Practice* (6th ed. 2000 & Supp. 2002), among its many other treatises, to assist attorneys whose clients have been victimized by unfair, fraudulent, or deceptive lending practices. In addition, NCLC has directly assisted attorneys in scores of cases brought under federal and state credit protection statutes. The Federal Trade Commission (FTC) designated NCLC as the consumer representative in proceedings that led to the agency's promulgation of its Rules on Preservation of Consumers' Claims and Defenses, 16 C.F.R. Pt. 433 (1998), and Credit Practices, 16 C.F.R. Pt. 444 (1998).

The Consumer Federation of America (CFA) is a non-profit association organized in 1967 to advance the interests of consumers through advocacy and education. CFA's current membership is comprised of almost 300 national, state, and local consumer groups throughout the United States, which, in turn, represent more than 50 million consumers.

CFA has been a leading advocate nationally of balanced consumer bankruptcy laws. In particular, CFA has advocated policies that would make chapter 13 bankruptcy a workable alternative for those who

need it. In addition, CFA has devoted considerable resources to advocacy and educational efforts to protect the interests of consumers in the credit market. CFA has published a series of reports on reckless lending by credit card issuers, abusive credit practices by check cashers, payday lenders and businesses that offer Refund Anticipation Loans, and high fees and deceptive practices among credit counseling agencies. See, e.g. Travis Plunkett and Stephen Brobeck, *Credit Card Issuers Expand Marketing and Available Credit While Consumers Increasingly Say No* (2002), Jean Ann Fox and Edmund Mierzwinski, Consumer Federation of America and U.S. Public Interest Research Group, *Rent-A-Bank Payday Lending – How Banks Help Payday Lenders Evade State Consumer Protections* (2001), and Deanne Loonin and Travis Plunkett, National Consumer Law Center and Consumer Federation of America, *Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants* (2003).

The issue before this Court involving the calculation of "present value" is critical to individual debtors who wish to keep their secured collateral and afford their chapter 13 plan payments. *Amici* are particularly concerned that affirmance of the opinion below will substantially undermine the calculated efforts made by Congress to encourage and enable debtors to file chapter 13 bankruptcies.

SUMMARY OF ARGUMENT

The Seventh Circuit's adoption of a presumptive contract rate approach to establish present value under 11 U.S.C. § 1325(a)(5)(B)(ii) is flawed. This approach is inaccurate, overcompensates creditors, and creates undue delay and litigation in the

bankruptcy courts. Further, it is contrary to the plain language and intention of the statute.

The presumptive contract rate approach does not accurately reflect the actual loan rate charged by creditors (even in the original loan). In many situations, the contract rate of return is reduced by a kick-back that a creditor gives to the original dealer or mortgage broker who initiated the loan. Furthermore, the contract rate is established well before the appropriate time to determine present value under the statute. Finally, the contract rate overcompensates creditors for risk. Creditors are already compensated for risk in a bankruptcy by other sections of the Bankruptcy Code, and further, the risk to creditors in chapter 13 bankruptcies is much lower than in the marketplace. These serious deficiencies in the presumptive contract rate approach result in the creditor usually receiving a better rate of return in a bankruptcy than in the marketplace. This clearly is not the intent of the statute.

From the perspective of *amici*, the Seventh Circuit's approach creates a monumental evidentiary hurdle for debtors to clear in order to defeat the presumptive contract rate. This high standard is exacerbated by the unwillingness of creditors to respond to discovery requests about their credit-granting standards and how those standards are applied to determine the actual rate of interest charged to a specific consumer. The creation of such a high evidentiary standard usually results in either debtors acquiescing to the high contract rate, which in turn affects their ability to afford the payments, or protracted litigation in order to force creditors to disgorge the requested information.

The presumptive contract rate approach also is at odds with the plain language and intention of the statute. If Congress had intended that the contract rate be presumed to be the present value rate, such language certainly would have been included in

section 1325(a)(5)(B)(ii). That language is absent for a simple reason. Congress intended not to reinstate a creditor's contract rights in the chapter 13 bankruptcy, but to compensate the secured creditor for the delay in receiving funds, paid over time through the chapter 13 plan. The Seventh Circuit's establishment of a severe presumption in favor of the contract rate is not consistent with the statute. There exist better, more consistent and fairer approaches to determine present value.

ARGUMENT

I. THE PRESUMPTIVE CONTRACT RATE APPROACH TO CALCULATE "PRESENT VALUE" IS FLAWED AND IS INCONSISTENT WITH THE BANKRUPTCY CODE.

a. The presumptive contract rate approach does not accurately reflect the interest rate of return the creditor actually will receive on a new loan of the same duration and risk. Instead, this approach overcompensates creditors.

In many secured loan transactions involving intermediate parties such as car dealers and mortgage brokers, the contract rate does not equal the rate of return that the creditor actually receives from the loan, nor does it reflect the level of risk faced by the creditor. Rather, the actual interest rate that a borrower qualifies for with the creditor is "marked-up" by the dealer or broker originating the loan by adding

several points of interest.[2] This increase is usually split in the form of a lump sum kick-back from the creditor to the dealer or broker. Therefore, the creditor actually receives less than the full contract rate of interest.

By requiring a debtor to presumptively pay the contract rate of interest in bankruptcy, the creditor is overcompensated by being paid more than it would have obtained had it foreclosed and reinvested the proceeds in a similar loan.[3] In the new loan outside of

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[2] The Sixth Circuit opinion in *Coleman v. General Motors Acceptance Corp.*, 296 F.3d 443 (6th Cir. 2002) provides a description of the markup process:

> [T]here are two components to the annual percentage rate ("APR") set in [GMAC's] retail installment sales contracts: the "Buy Rate" and the "Finance Charge Markup". The "Buy Rate" is the portion of the APR that "is the risk- related interest rate required by GMAC for a particular transaction." The "Finance Charge Markup" is "the non-risk charge added to the Buy Rate" by the dealer who must not exceed a limitation set by GMAC's policy. According to the plaintiff, there are incentives in GMAC's retail finance system to "encourage imposition of the subjective non-risk related markup."

Coleman v. General Motors Acceptance Corp., 296 F.3d 443, 445 (6th Cir. 2002), *citing and vacating Coleman v. General Motors Acceptance Corp.*, 196 F.R.D. 315, 318 (M.D. Tenn. 2000).

[3] The court below described the coerced loan approach as follows:

> "Courts taking this view [the coerced loan approach] conceptualize the cramdown provision as forcing creditors to extend a new line of credit to the debtor. Consequently, 'the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk.'" *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002), *citing Koopmans v. Farm Credit Servs. of Mid-America, ACA*, 102 F.3d 874, 875 (7th Cir. 1996).

bankruptcy, interest earned on the reinvested proceeds will be shared with the car dealer or mortgage broker, thereby substantially reducing the amount it would earn in bankruptcy if given the contract rate. This is true even without considering other transactional or relational costs that the creditor would incur in making a new loan with the foreclosure proceeds.

In a hypothetical example, a consumer debtor buys a car from a dealer for $15,000.00 at 21% interest. The financing creditor, however, approves the debtor for a 17% interest rate loan, taking into account the consumer's credit profile and risk to the creditor, based on the creditor's underwriting guidelines. The dealer tells the debtor that the best rate that it can arrange is 21%.[4] The creditor and the dealer then share the additional 4% interest yield. The creditor therefore will receive substantially less than the interest earned at the 21% contract rate. The actual interest rate charged in this example does not reflect the dealer's or creditor's actual transaction costs.

This practice of marking up loans is not limited to the automobile industry. As noted by the Eleventh Circuit in a case involving the payment of "yield spread premiums" to brokers in the home mortgage market,[5] the formula used to mark up interest rates

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[4] In *Coleman v. General Motors Acceptance Corp.*, the consumer plaintiff qualified for an auto loan at the rate of 18.25% under the lender's pricing system, but the dealer "exercised its discretion under the Finance Charge Markup Policy ("markup policy") to increase her interest rate to 20.75%." *Coleman v. General Motors Acceptance Corp.*, 296 F.3d 443, 445 (6th Cir. 2002).

[5] The Department of Housing and Urban Development estimates that mortgage brokers originate more than 60% of the nation's mortgages. *See* RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers, 67 Fed. Reg. 49134 (July 29, 2002), available at: http://hudclips.org/sub_nonhud/cgi/pdf/18960.pdf.

bears no relation to the actual broker services provided in originating the loan:

> The "yield spread premiums" at issue in this case . . . are payments from [the lender] to its mortgage brokers that the written agreement between them contemplates, but does not define. Each business day, [the lender] distributes a rate sheet to its brokers, listing the terms of the loans [the lender] is offering that day. The loans' interest rates are set with reference to a "par rate." If the broker originates a loan at a below-par rate, it gets no compensation from [the lender]. On the other hand, originating a loan at an above-par rate garners the broker a yield spread premium, whose amount is determined by a formula that includes the amount of the loan and the difference between the loan rate and the par rate. The formula does not take into account the amount of work the broker actually performed in originating the loan or how much the borrower paid in fees for the broker's services.

Culpepper v. Irwin Mortgage Corp., 253 F.3d 1324, 1325 (11th Cir. 2001), *cert. denied*, 122 S.Ct. 930 (2002).[6]

See also *United Carolina Bank v. Hall*, 993 F.2d 1126, 1131 (4th Cir. 1993)(court refused to presumptively apply the contract or "gross" interest rate as an estimate of present value due to fact that

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[6] While most mortgages in a chapter 13 bankruptcy are paid pursuant to 11 U.S.C. § 1322(b)(2), many are paid pursuant to section 1325(a)(5). When a mortgage loan matures prior to the end of the bankruptcy, the loan may be paid under section 1325(a)(5). 11 U.S.C. § 1322(c)(2).

creditors often buy loan contracts from mobile home dealers at a discount).

The common practice of marking up interest rates on consumer loans severely undermines the assumption in the lower court's opinion that the contract rate is an accurate approximation of the interest rate that the creditor would receive on a new loan of the same duration and risk. The marked-up interest rate does not reflect risk because the creditor has already approved the loan, taking risk into consideration, at the lower "par" rate.

This disparity between the final marked-up interest rate charged to the borrower and the level of risk to the creditor is even more dramatic in the subprime consumer loan market. Recent research conducted of the subprime mortgage market suggests that often there is little or no justification based on risk for the large differential in rates charged by many subprime lenders.[7] Another report suggests that subprime mortgage borrowers are often charged rates that are not commensurate with their credit profiles, and that approximately 10% to 35% of subprime borrowers could qualify for lower cost, conventional "prime" financing.[8]

Since risk is not considered in the marked-up interest rate, a creditor's interest rate for similarly

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[7] *See, e.g.*, Howard Lax, Michael Manti, Paul Raca, and Peter Zorn, "Subprime Lending: An Investigation of Economic Efficiency," (Feb. 25, 2000) (Freddie Mac study that compared the interest rates on subprime loans rated A-minus by the lenders originating these loans, with the rates on prime loans purchased by Freddie Mac, which Freddie Mac then rated A-minus using its underwriting model; Freddie Mac found that, on average, the subprime loans bore interest rates that were 2.15% [215 basis points] higher than its loans; the study could find no justification for such a large discrepancy).

[8] *See*, Freddie Mac, "Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families", Chapter 5, September, 1996, available at: http://www.freddiemac.com/corporate/reports/moseley/chap5.htm.

situated debtors may vary greatly depending upon the ability of the dealer or broker to "upsell" the loan to individual consumers. This is particularly true in the subprime market for lenders such as the respondent in this case. *In re Till*, 301 F.3d at 593 (*dissenting opinion*)("By its own account, the interest rate that SCS charges its customers for sub-prime, used car loans is whatever the market will bear.").

The use of a presumptive contract rate as an approximation of what creditors would charge similarly situated debtors under a coerced loan approach may have a racially discriminatory effect based on evidence suggesting that the mark-up practice in the automobile industry has resulted in a discriminatory impact on racial minorities.[9] In one recent lawsuit challenging the practice, an automotive finance company has agreed to institute a credit pre-approval program offering "no markup" rates to black and Hispanic buyers who have never declared bankruptcy or had cars repossessed.[10]

The practice of interest rate mark-ups has drawn attention from state governments. On July 14, 2003, the State of California enacted legislation to curb the mark-up of interest rates. Cal. Civil Code § 2984.5. This statute requires lenders to maintain records concerning the loan and creditworthiness of the consumer for up to seven years, to enable the California Attorney General to investigate possible

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[9] *See* "Final Report on Racial Impact of NMAC's Finance Charge Markup Policy" issued in *Cason et al vs. Nissan Motor Acceptance Corporation*, Case No. 3-98-0223 (C.D. Tenn.) available at: http://www.nclc.org/initiatives/cocounseling/content/Final Report.pdf.

[10] The settlement provides that the company will make 675,000 such offers over five years. *See* Associated Press, *Nissan Proposes Discrimination Settlement*, N.Y. Times, February 20, 2003, available at: http://www.nclc.org/initiatives/cocounseling/content/NYTimes_article.pdf.

violations of the law.[11] The legislative history of Cal. Civil Code § 2984.5 reflects the concerns of the Committee of the Judiciary of the California State Assembly in the reported interest rate abuses by car dealers and lenders. [12]

In sum, the contract rate that many consumers pay is not based on their risk factors but instead reflects their vulnerability to predatory lending tactics or the racially discriminatory impact of mark-up practices. As such, the presumptive contract rate is an inaccurate and faulty approach to determine present value. It does not recognize that the marked-up portion of the interest rate is received by the dealer or broker, not the lender. When used broadly for all secured loans, as required by the Seventh Circuit, it overcompensates many secured creditors by paying them more interest than they would receive outside of a bankruptcy on a new loan of the same duration and risk.[13]

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[11] Danny Hakim, *Davis Signs Fair Lending Bill*, N.Y. Times, July 16, 2003, available at: http://www.carconsumers.com/cars_in_the_news-govD.html.

[12] "This bill is intended as a first step in addressing abuses by some car dealers when they arrange loans for buyers. **As has been widely reported in the press, and is being litigated in numerous lawsuits, many buyers who finance through the dealership are charged an interest rate several percentage points higher than what is approved by the lender, even while being told that they are getting the best rate available. The additional markup amount is then reportedly split between the lender and the dealer.** Several lawsuits allege that these markups are made in a discriminatory manner, disproportionately affecting African-American and Latino buyers." (Emphasis added.) Assembly Judiciary Committee Analysis, SB 508, 2003-2004 Regular Session, (June 10, 2003), available at: http://www.leginfo.ca.gov/pub/bill/sen/sb_0501-0550/sb_508_cfa_ 20030610_163357_asm_comm.html.

[13] The presumptive contract rate is also inaccurate based on the timing of the valuation of "present value." The Seventh Circuit's intent in mandating the use of the presumptive contract rate method is to estimate the coerced loan rate of interest at the

b. The presumptive contract rate approach overcompensates creditors for risk.

The presumptive contract rate approach overcompensates creditors for risk.[14] Outside of bankruptcy, creditors appropriately charge a higher rate of interest to offset risk. This risk premium is included in the contract rate of interest. In a chapter 13 bankruptcy, however, other statutory provisions protect creditors from risk and actually lower the creditor's risk.

First, if the creditor is undersecured or thinly secured, it has a right to adequate protection. Section 361 is the primary section of the bankruptcy code ensuring creditors of adequate protection. This section defines adequate protection as including periodic cash payments to the extent that the automatic stay against repossession results in a

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time the bankruptcy plan is confirmed. *In re Till*, 301 F.3d 583, 592 (7th Cir. 2002). The problem with the Seventh Circuit's approach is that a contract is normally consummated well before a chapter 13 plan is filed or confirmed. The interest rate established in the contract is based on the factors present as of the time of the consummation of the contract. When a bankruptcy is filed, the factors that affect interest rates may well have changed. This is demonstrated by the fluctuation of Treasury Bill rates from 1998-2000. See "Economic Trends," Federal Reserve Bank of Cleveland, p. 8 (Nov. 2002) at http://www.clev.frb.org/research/Et2002/1102/Trends.pdf and "What makes Treasury bill rates rise and fall? What effect does the economy have on T-Bill rates?" Federal Reserve Bank of San Francisco (Dec. 2000) at http://www.frbsf.org/education/activities/drecon/2000/0012.html.

[14] The rationale supporting the presumptive contract rate approach states that a creditor "is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002). The Respondent argues that it should be entitled to contract rate to compensate it for the risk of non-payment on its loan. SCS's Brief and Supplemental Appendix to the Seventh Circuit, pp. 29-30.

decrease in a secured creditor's interest in the property. Thus, the creditor has the right to demand that payments it is to receive under the plan will at least keep up with the property's depreciation. Similarly, the concept of adequate protection clearly encompasses the right to have the property insured.

Second, if the debtors make sporadic payments or no payments in their chapter 13 plan, the creditor can receive relief from the automatic stay pursuant to 11 U.S.C. § 362(d). At that point, the creditor is entitled to immediate return of its collateral, the case typically is dismissed, and the creditor has the right to revert to state law remedies. In other words, the creditor will be able to collect not only its contract interest rate but also, under almost every form consumer credit contract, all of the attorney fees and costs that it incurred during the bankruptcy. The presumption of the contract rate to protect present value is simply not relevant if the plan fails; therefore, the possibility of plan failure is not a valid basis for requiring the contract rate.[15]

Third, there are other protections in place in a chapter 13 to protect a secured creditor and reduce its risk. All debtors must submit all or such portion of their income to the supervision and control of the trustee as is necessary to execute the plan. 11 U.S.C. § 1322(a)(1). Debtors usually are ordered by the bankruptcy court to have their chapter 13 plan payments deducted directly from their wages

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[15] In this regard, there is far less risk to the creditor than in a chapter 11 case. In a chapter 11 case, the debtor receives a discharge immediately upon confirmation. 11 U.S.C. § 1141(d). If the debtor does not pay pursuant to the confirmed plan, the creditor must often enforce its rights in state court, but the debtor still retains the discharge of the unsecured portion of the claim. In a chapter 13, the debtor must complete his plan payments in order to obtain a full chapter 13 discharge. 11 U.S.C. § 1328(a). A chapter 13 bankruptcy thus protects creditors to a greater extent than does a chapter 11 by requiring completion of the plan before the debtor receives a discharge.

pursuant to 11 U.S.C. § 1325(c), increasing the likelihood that the plan will complete and the creditors will be paid.[16] The chapter 13 trustee monitors, collects and disburses funds to the creditor, and also enforces the creditor's rights to plan payments, if necessary, through motions to dismiss for nonpayment pursuant to 11 U.S.C. §§ 1302 and 1307 or motions to increase payments pursuant to 11 U.S.C. § 1329(a).[17] The creditor also is entitled to file motions to dismiss or to convert the case to a chapter 7 under 11 U.S.C. § 1307.

Fourth, this Court compensated creditors for risk when the Court adopted replacement value as the standard for determining the value of collateral under section 506(b). *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879 (1997). The Court held that debtors are to pay the replacement value of collateral, as opposed to a foreclosure value of collateral, based in part on the goal of compensating creditors for risk.

> If a debtor keeps the property and continues to use it, the creditor obtains at once neither the property nor its value and is exposed to double risks: The debtor may again default and the property may deteriorate from extended use. Adjustments in the interest rate

[16] *In re Torres*, 191 B.R. 735, 737 (Bankr. N.D. Ill. 1996)("...since one of the requirements for confirmation is a showing that 'the debtor will be able to make all payments under the plan.' 11 U.S.C. § 1325(a)(5). A preconfirmation wage deduction order establishes the debtor's ability to make plan payments, despite prior budgeting difficulties. It may well make the difference between success and failure of a chapter 13 case.")

[17] The trustee saves the creditor a substantial amount of time and expense by essentially operating as the creditor's unpaid collection agent. The creditor does not pay for these tasks, which instead are paid for by the debtor, who pays the trustee's fees through the bankruptcy plan. 11 U.S.C. §§ 330(c) and 1326(b)(2).

> and secured creditor demands for more "adequate protection," 11 U.S.C. § 361, do not fully offset these risks.

520 U.S. at 962-963, 117 S.Ct. at 1885.

The Seventh Circuit's presumptive contract rate approach overcompensates creditors by double-counting for risk, considering risk in determining both the valuation of the property and the interest rate. The following hypothetical illustrates overpayment to the creditor under the presumptive contract approach after *Rash*. A consumer buys a vehicle for $15,000.00 at 21% interest. At the time of the bankruptcy, the replacement value of the car, pursuant to the Court's decision in *Rash*, is $10,000.00. If the creditor were able to repossess the vehicle, it would be sold at its wholesale/foreclosure value for $5,000.00.[18] Pursuant to the underlying coerced loan theory of *Till*, the creditor would then loan this sum at 21% over 36 months, and it would receive $6,782.00 ($1,782.00 in interest).[19]

However under the Seventh Circuit's presumptive contract rate approach, the creditor is entitled to be paid $10,000.00 at 21%. At the end of a three year plan, the creditor would be paid $13,564.00 ($3,564.00 in interest), far in excess of what it could have earned had the collateral been repossessed and sold under state law.

[18] *In re Weathington*, 254 B.R. 895, 900 (B.A.P. 6th Cir. 2000) ("...the commercial reality is that creditors that repossess vehicles most often sell them wholesale at auctions."); *In re Zell*, 284 B.R. 569, 573 (Bankr. D. Md. 2002)("The value Chevy Chase Bank would have received if it had repossessed the vehicle, is the wholesale value of the car.")

[19] "Consequently, 'the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk.'" *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002), *citing Koopmans v. Farm Credit Servs. of Mid-America, ACA*, 102 F.3d 874, 875 (7th Cir. 1996).

Contrast this result with the goal of section 1322(a)(5)(B)(ii), as stated by the Seventh Circuit in *Till* as **"seek[ing] to put the secured creditor in an economic position equivalent to the one it would have occupied had it received the allowed secured amount immediately, thus terminating the relationship between the creditor and the debtor."** (emphasis added) *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002).

By requiring the debtor to pay the contract rate of interest on the replacement value of the collateral, **the Seventh Circuit gives the creditor twice the amount of interest it would have received had the debtor surrendered the property ($3,564.00 compared to $1,782.00).** The presumptive contract rate approach overcompensates creditors by double-counting for risk, considering risk in determining both the valuation of the property and the interest rate. This is clearly not the intent of section 1325(a)(5)(B)(ii).

The *Till* court missed the point of section 1325(a)(5)(b). That section is designed to compensate the creditor more for the time value of money and less for risk. The primary rights and safeguards protecting secured creditors from risk spring from numerous other sections of the Bankruptcy Code, including 11 U.S.C. §§ 361, 362, 506, 1302, 1307, 1322, 1325(c) and 1329, not the present value test of section 1325(a)(5).[20] That Congress established these separate protections against risk militates against the

[20] While it is true that this Court dealt with this issue of adequate protection and not the issue of plan interest rates in *Timbers*, in that case, the Court also recognized the Congressional intent to protect unsecured creditors by reducing, at least to some degree, secured creditors' rights to interest. *United Savings Association v. Timbers of Inwood Forest*, 484 U.S. 365, 373, 108 S.Ct. 626, 631 (1988), (unfair to pay undersecured creditor interest from estate's unencumbered assets before unsecured creditors had recovered any principal) *citing Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 164, 166, 67 S.Ct. 237 (1946).

argument that creditors should be presumptively paid the contract rate of interest to protect them against risk.

c. The presumptive contract rate approach creates delay and inefficiency in the administration of a chapter 13 bankruptcy.

The presumptive contract rate approach imposes a monumental burden of proof upon debtors that causes delay and inefficiency. Under this approach, debtors are required to demonstrate that the creditor would charge an interest rate different than the contract rate when lending money to a similarly situated debtor.

The problem arises from the fact that the creditor itself is typically the only source of information to rebut this presumption. For example, many creditors create rate sheets that set forth their rates of return (kickbacks) to the initial dealers or mortgage brokers after mark-up. Also, creditors have their own individual formulas for calculating the initial rate of interest on a loan. There is no other source than that specific creditor for this information. Unfortunately, debtors, who are paying all their disposable income into the plan (as required by 11 U.S.C. § 1325(b)(1)), rarely have additional funds to hire an expert and conduct an independent investigation.[21]

Following the Seventh Circuit's ruling in *Till*, debtors must exercise their rights for formal discovery under Bankruptcy Rules 9014 and 7026-7037

[21] "Given that the most undeniable element in this entire equation is that most chapter 13 debtors will not possess the resources necessary to finance a full-scale litigation of the presumption issue, it seems apparent that the imposition of the contract rate will simply be a foregone conclusion in the vast majority of chapter 13 cases." *In re Richard*, 241 B.R. 403, 409 (Bankr. E.D. Tex. 1999).

(depositions, interrogatories, requests for production, etc.) to obtain this information. A secured creditor faced with requests for information normally objects and refuses to produce the information. Attorneys for consumers seeking information on the establishment of the contract interest rate then must file and argue motions to compel discovery pursuant to Bankruptcy Rule 7037. In response, the creditor then usually files a motion for protective order pursuant to Bankruptcy Rule 7026. This has occurred in bankruptcy cases in which the debtor has attempted to obtain this information[22] and in class action lawsuits against Nissan and General Motors Acceptance Corporation.[23]

In some instances, the creditors may have legitimate concerns about releasing information concerning trade secrets, confidential research and development, or commercial information concerning their credit granting standards. The resolution of these concerns may entail lengthy hearings and complex findings and orders of the court to compel discovery while protecting the creditor.

An important goal in the management of a chapter 13 bankruptcy is the minimization of litigation and administrative costs.[24] The presumptive contract

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[22] Debtors have filed motions to compel discovery answers to challenge the presumptive contract rate in *In re Hartman*, Case No. 02-34092 (Bankr. S.D. Ill. 2002)(Document #50 Motion to Compel, #53 Objection to Motion to Compel), *In re Foxworth*, 03-30208 (Bankr. S.D. Ill. 2003)(Document #51 Motion to Compel, #56 Objection to Motion to Compel). *See also* Cal. Civil Code § 2984.5, which was enacted to make discovery of this information easier.

[23] *Cason et al vs. Nissan Motor Acceptance Corporation*, Case No. 3-98-0223 (C.D. Tenn.), *Coleman et al vs. General Motors Acceptance Corporation*, Case No. 3-98-0211 (C.D. Tenn.).

[24] "Since chapter 13 cases adjust the debts of the individual wage earner, such cases tend to be rather high in volume and low in absolute value, making a reduction of the litigation and transactions costs of chapter 13 cases an important prudential consideration." *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 70 (3rd Cir. 1993). See also *Matter of Smithwick*, 121 F.3d 211, 214 (5th Cir. 1997).

rate approach's heavy discovery requirement, coupled with the reluctance of creditors to cooperate, conflicts with this goal. The presumptive contract rate approach thus delays the chapter 13 plan confirmation process and the ease of administration and payment of claims. Surely this is not the intent of section 1325(a)(5)(B)(ii).

d. The presumptive contract rate approach is contrary to the plain language of section 1325(a)(5)(B)(ii).

The plain language of section 1325(a)(5)(B)(ii), contrasted with other provisions of the Bankruptcy Code, indicates that Congress intentionally omitted the requirement that debtors presumptively pay the contract rate of interest to compensate creditors for their present value interest. Under the maxim *expressio unius est exclusio alterius*, "the expression of one thing is the exclusion of another," an express statutory requirement here, contrasted with statutory silence there, shows an intent to confine the requirement to the specified instance. In *Field v. Mans*, 516 U.S. 59, 116 S.Ct. 437 (1995) this Court wrote:

> The argument relies on the apparent negative pregnant, under the rule of construction that an express statutory requirement here, contrasted with statutory silence there, shows an intent to confine the requirement to the specified instance. See *Gozlon-Peretz v. United States*, 498 U.S. 395, 404, 111 S.Ct. 840, 846-847, 112 L.Ed.2d 919 (1991) ("'[W]here Congress includes particular language in one section of a

> statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.'") (quoting *Russello v. United States*, 464 U.S. 16, 23, 104 S.Ct. 296, 300, 78 L.Ed.2d 17 (1983)).

516 U.S. at 67, 116 S.Ct. at 442.

In section 1325(a)(5)(B)(ii), Congress did not include the term "contract" or similar terms evidencing payment pursuant to the contract or agreement. Congress, however, did include these terms clearly in other sections of the Bankruptcy Code. See 11 U.S.C. § 1322(e) (debtor curing a mortgage arrearage claim must pay interest on that claim if provided for in the agreement) and 11 U.S.C § 506(b) (creditor entitled to payment of contract interest when the value of the collateral exceeds the lien on the collateral). The fact that Congress placed specific requirements to pay contract interest in other sections of the Bankruptcy Code, but was silent on contract interest in section 1325(a)(5)(B)(ii), indicates that Congress did not intend to require debtors to pay contract interest when paying present value.

This interpretation is consistent with the Court's recent case of *F.C.C. v. NextWave Personal Communications Inc.*, 123 S.Ct. 832, 842 (2003). This Court held that Congress means what it says. In contrast, the Third, Fifth and Seventh Circuits have ignored the plain language of the Code, circumvented Congressional intent and legislated the presumptive contract rate approach.

e. A chapter 13 plan is not a loan transaction, and the present value calculation under section 1325(a)(5)(B)(ii) should not be presumptively based on the debtors' contract rate. Other, more appropriate methods can be used to compensate a secured creditor for present value.

The presumptive contract rate approach, and the underlying coerced loan theory, posit that the appropriate present value rate to be paid to a secured creditor best approximates "the rate it would voluntarily accept for a loan of similar character." *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 67 (3rd Cir. 1993).

The fundamental flaw in this approach is that a chapter 13 bankruptcy case is not a loan transaction voluntarily bargained for by a creditor, but rather a multiparty collective proceeding established by Congress to rehabilitate individual debtors and to ensure fair treatment of all creditors. The legislative history of chapter 13 and the 1978 Bankruptcy Code is replete with references to these twin basic bankruptcy objectives -- a fresh start for the consumer debtor and equity among creditors.[25]

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[25] "The premises of the bill with respect to a consumer bankruptcy are that use of the bankruptcy law should be a last resort; that if it is used, debtors should attempt repayment under chapter 13 ...; and, finally, whether the debtor uses chapter 7 ... or chapter 13 ..., bankruptcy relief should be effective, and should provide the debtor with a fresh start... The purpose of chapter 13 is to enable an individual, under court supervision and protection, [to] develop and perform under a plan for the repayment of his debts over an extended period. In some cases, the plan will call for full repayment. In others, it may offer creditors a percentage of their claims in full settlement ... This protection relieves the debtor from indirect and direct pressures from creditors, and enables him to support himself and his dependents while repaying his creditors

Nothing in the history of chapter 13 suggests a purpose of fully protecting the bargain of the secured creditor at the cost of meeting those objectives.

The provisions of section 1325(a)(5)(B) are intended to protect the property rights of secured creditors. A secured creditor may oppose confirmation of a chapter 13 plan unless the plan protects its property interest, i.e., its lien on the debtor's property. The Code provides two alternative methods of protection: surrender of the property to the creditor (after which any remaining deficiency claim of the creditor is treated no differently than other unsecured claims) or the "cramdown" of section 1325(a)(5)(B). Under the latter, the secured creditor is permitted to retain its lien after confirmation of the debtors' plan, giving it protection against other creditors and the possibility of the plan's failure, and receive payment on the full replacement value (as opposed to its foreclosure value) on its secured claim.[26]

The purpose of section 1325(a)(5)(B)(ii), normally met by the payment of interest, is to ensure that the secured creditor's property rights are not prejudiced by any delay in payment due to the chapter 13 plan. This purpose can be seen clearly from the alternative available under the Code. The alternative,

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at the same time. The benefit to the debtor of developing a plan of repayment under chapter 13, rather than opting for liquidation under chapter 7, is that it permits the debtor to protect his assets. In a liquidation case, the debtor must surrender his nonexempt assets for liquidation ... Under chapter 13, the debtor may retain his property by agreeing to repay his creditors. Chapter 13 also protects a debtor's credit standing far better than a straight bankruptcy ... The benefit to creditors is self-evident: their losses will be significantly less than if their debtors opt for straight bankruptcy." H.Rep. No. 95-595, pp. 116-118 (1977), U.S. Code Cong. & Admin.News 1978 pp. 5787, 6076, 6078.

[26] "Our recognition that the replacement-value standard, not the foreclosure-value standard, governs in cram down cases..." *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 965, 117 S.Ct. 1879, 1886 (1997).

absent some other agreement by the creditor, is for the creditor to receive the collateral.

The *Till* court, and others adopting similar holdings, fail to recognize that the Code's purpose is simply to protect the creditor's property right -- the right to get the same amount as if it had received its collateral. Instead, those courts attempt to reinstate the secured creditor's contract rights, i.e., the benefit of its bargain and the debtor's concomitant obligations, by treating the plan as a "forced loan" with an interest rate presumptively the same as in the original contract. This contract interest rate does more than compensate for the delay in payment. It requires the debtor to pay a rate that includes transaction costs, profit, and a premium for risk; in other words, all of the benefits of the bargain that the creditor received in the original contract. This is not the intent or the focus of section 1325(a)(5)(B)(ii).

Further, adopting the presumptive contract rate approach will reward the most exploitive and overreaching creditors and is unfair to other creditors. Two secured creditors with similar property interests may receive radically different treatment. For example, under the presumptive contract rate approach, a debtor in a chapter 13 plan could be required to pay 8% interest to the holder of a third mortgage and 20% interest to the holder of a second mortgage on the same property, even if both mortgages were fully secured and there was substantial equity.

Unsecured creditors are prejudiced as well. Unsecured creditors usually receive whatever is left from the debtor's disposable income after secured creditors are paid. If that pot of disposable income is depleted because a secured creditor is receiving compensation for profits, costs and risk, the unsecured creditors receive less on their principal debt, despite taking risks that were greater than those of the secured creditor. Both secured and unsecured

creditors have contract rights, transaction costs, and intend to make profits. Since the only valid distinction between secured and unsecured creditors in the Code is that the former has a property interest, the interest rate should not go beyond that which is absolutely necessary to protect that interest.

Amici firmly believe that this Court should adopt a method to fairly protect the creditor while not overcompensating the creditor in the process. This method should be based on the time value of money, taking into account current market rates of interest to approximate the creditor's actual losses due solely to delay because of the bankruptcy. It should not compensate the creditor for the profit it would have received outside the bankruptcy. *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997), *In re Dominick*, 244 B.R. 51 (Bankr. N.D. N.Y. 2000), *In re St. Cloud*, 209 B.R. 801 (Bankr. E.D. Mass. 1997).

It should not overcompensate the creditor for risk factors as well. Instead, this Court should allow the bankruptcy judge some discretion to determine if the interest rate to be allowed should be increased by a small, additional risk premium.

This is the approach used in *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997). *Valenti* seeks to compensate the creditor for its actual loss of use of money while not overcompensating for risk. *Valenti* has the virtue of referring to a well defined, national standard and making slight additional adjustments for risk that fairly balance the interest of all creditors and debtors in the bankruptcy process. It streamlines the process by allowing a hearing only on the small risk premium, and only after the parties are unable to agree.

Amici also firmly believe that this Court should not adopt the "forced loan" approach of *Till* and its predecessors.

> These courts have treated the chapter 13 deferral of payments like a new loan transaction, which provides the holder of the allowed secured claim with not only the cost of the funds it would lend but also the costs of a new loan transaction, which would not be incurred, and the profit that would be earned in that transaction. Neither of these latter two amounts would be received if the collateral were surrendered; the lender would have to incur new transaction costs to earn an additional profit. To include them in the present value discount rate gives the holder of an allowed secured claim more than the equivalent of immediate payment of that claim in full.

Collier on Bankruptcy, ¶ 1325.06[3][b] pp. 1325-36 (15th Ed. 2002).

Finally and most importantly, the Court should not legislate an impossible presumption as to the interest rate to be applied where no such presumption is contained in the Code. The Court should give bankruptcy judges discretion as to the factual determination of the interest rate to be applied.[27] This is consistent with the Court's review of section 1325(a)(5) in *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879 (1997). In *Rash*, the Court stated that it is necessary to give bankruptcy judges discretion as to the issue of value, noting that:

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[27] It is important to note that in locations of the country where a non-presumptive contract rate approach has been applied, it is the experience of NACBA and its attorneys that it is uncommon for debtors and creditors to constantly litigate issues of present value interest. In most areas, counsel for debtors and creditors routinely meet and agree on a simple mathematical formula to apply in most cases. This method allows flexibility for changes based on fluctuations in the economy, and for regional differences in credit and collateral.

> Our recognition that the replacement-value standard, not the foreclosure-value standard, governs in cram down cases leaves to bankruptcy courts, as triers of fact, identification of the best way of ascertaining replacement value on the basis of the evidence presented.

520 U.S. at 965, 117 S.Ct. at 1886.

In *Till*, the Seventh Circuit effectively removed any discretion from the bankruptcy courts with its adoption of the presumptive contract rate approach.

CONCLUSION

For all the foregoing reasons, this Court should reverse the decision below of the Seventh Circuit.

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IN THE

Supreme Court of the United States

LEE M. TILL, et ux.,

Petitioners,

v.

SCS CREDIT CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

AMICUS CURIAE BRIEF OF THE NATIONAL ASSOCIATION OF CHAPTER THIRTEEN TRUSTEES SUPPORTING PETITIONERS

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

The National Association of Chapter Thirteen Trustees ("NACTT") is a non-profit, educational organization composed of consumer bankruptcy professionals.[1] Its membership represents a broad spectrum of participants in the consumer bankruptcy process including debtors' attorneys, creditors' representatives, and Standing Chapter 13 trustees. The NACTT's voting membership is composed of private trustees appointed by the U.S. Department of Justice, Executive Office of the U.S. Trustee (see 28 U.S.C. § 586) and in the federal judicial districts of North Carolina and Alabama by the judiciary. Approximately 98% of the Standing Chapter 13 trustees in the United States are voting members of the NACTT. Andrea Celli, a Standing Chapter 13 Trustee for the Northern District of New York and current President of the NACTT, and the NACTT's Board of Directors, ratified by the NACTT's voting membership, have directly authorized Henry E. Hildebrand, III, Standing Chapter 13 Trustee in the Middle District of Tennessee, to prepare and submit this *amicus curiae* brief on the NACTT's behalf.

Historically, Congress and federal courts have observed that the more efficient and effective Chapter 13 programs have been conducted by Standing Chapter 13 trustees who exercise a broad range of responsibilities in both the design and effectuation of Chapter 13 plans. *Matter of*

---

1. The parties have consented to the filing of this brief. Their letters of consent are being filed herewith. This brief has been authored in its entirety by undersigned counsel for the *amicus curiae*. No person or entity, other than the named *amicus* and its counsel, made any monetary contribution to the preparation and submission of this brief.

Maddox, 15 F.3d 1347, 1355 (5th Cir. 1994). A Chapter 13 trustee has a statutory responsibility to participate in the confirmation and administration of every Chapter 13 plan. *See* 11 U.S.C. § 1302. The trustee represents the interests of all creditors by exercising various powers to ensure that the collection of the debtor's disposable income and disbursement of that money to creditors pursuant to the plan occurs according to the dictates of Congress as set forth in the Bankruptcy Code. *Maddox*, 15 F.3d at 1355. A Chapter 13 trustee, like bankruptcy trustees in general, is charged with the representation of general creditors and is empowered to assert claims, avoid preferences, collect property of the estate, and examine and object to creditors' claims in furtherance of the congressional goal of equitably distributing property of the estate to the creditors. *Id.* at 1355; *See In re Gustav Schaeter Company*, 103 F.2d 237 (6th Cir. 1939). The goals of bankruptcy include maximizing the greatest economic benefit to the greatest number of participants in the bankruptcy process.[2] A trustee, as the principal administrator of a Chapter 13 case, is charged with the responsibility of maximizing the possible return for distribution to creditors. *See In re Kessler*, 186 F. 127 (2nd Cir. 1911).

Bankruptcy is thus a collective legal process, where the differing constituencies are best served by a fair and equitable modification of various rights for the common good.

2. Bankruptcy and the policies that shape it have a number of constituencies invested in the outcome. One commentator has identified them as voluntary creditors, owners (debtors or shareholders), tort creditors, employees and the general community. Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, 1994 U. Ill. L. Rev. 1.

Accordingly, the automatic stay[3] precludes immediate repossession of collateral by secured lenders to preserve income producing potential for the entire estate and the trustee's strong-arm powers[4] and other avoidance powers prevent unfair pre-petition favoritism amongst creditors. In the same way, a restructuring of the rights between a debtor and a secured creditor under Chapter 13 of the Bankruptcy Code should be accomplished with the goal of preserving the property interests of that creditor in its collateral while still giving the reorganizing debtor the opportunity to repay *all* creditors as much as possible.[5] To the extent that any creditor, secured, unsecured, or otherwise, receives a distribution that is greater than the fair distribution required by law, such cost is born, not by the debtor, but by the other creditors and constituencies and such makes financial rehabilitation more difficult. Chapter 13 trustees seek to implement fairness to all creditors and avoid inequitable distributions of estate property.

In consideration of the foregoing, Standing Chapter 13 trustees are in a unique position to objectively argue the issues raised in this review. Adoption of the Seventh Circuit's ruling in *In re Till*, 301 F.3d 583 (7th Cir 2002) that application of a creditor's contract rate of interest to its allowed secured

3. 11 U.S.C. § 362.

4. 11 U.S.C. §§ 544, 547, 549.

5. *See, e.g.*, Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 Columb. L. Rev. 717 (1991) ["In responding to financial distress, bankruptcy law sometimes should and must alter rights recognized under substantive non-bankruptcy law. This is not a forbidden act, as the economic account suggests; it is an essential and inevitable part of a full response to the problem of financial distress."]

claim, absent persuasive evidence otherwise, is presumptive of the value, as of the effective date of the plan, of property to be distributed under a Chapter 13 plan would impair equitable distributions to all creditors in most Chapter 13 cases. The *amicus* asserts that the language of the Bankruptcy Code, its underlying legislative history, and decades of bankruptcy policy support the conclusion, contrary to the Seventh Circuit's ruling, that the contract interest rate is not the source of the present value factor and bears no part in determining the "value, as of the effective date of the plan" of an allowed secured claim under 11 U.S.C. § 1325(a)(5)(B)(ii). The NACTT believes that the Seventh Circuit's interpretation of that statute will result in the formulation of Chapter 13 plans that artificially favor a particular creditor's interests at others' expense.

SUMMARY OF THE ARGUMENT

In *In re Till*, 301 F.3d 583 (7th Cir 2002), the Seventh Circuit Court of Appeals ruled that a creditor's contract rate of interest, absent persuasive evidence otherwise, together with the replacement value of the creditor's collateral, is presumptive of the value, as of the effective date of the plan, of property to be distributed under a Chapter 13 plan on account of the creditor's allowed secured claim as set forth in 11 U.S.C. § 1325(a)(5)(B)(ii). The plain meaning of § 1325(a)(5)(B)(ii) does not require the debtor to pay the contract interest rate. Principles of statutory construction, legislative history and bankruptcy policy, supported by correctly decided case law, show that § 1325(a)(5)(B)(ii) requires the debtor to pay the present value of the allowed secured claim. "Present value" and "interest" are two separate and distinct economic concepts. Present value is based upon the common sense notion that a dollar paid to you one year

from now is less valuable to you than the dollar paid to you today. Interest, on the other hand, has been said to represent the price of the use of money and can include the expected rate of inflation, the riskiness of the borrower, the liquidity of the borrowing investment, and the time to maturity.

In *Till*, the Seventh Circuit has adopted a "coerced loan" approach to determine present value which focuses on the secured creditor's specific contract rate. The "coerced loan" approach is flawed. It is not authorized by statute or legislative history and it confuses "present value" with "interest." It undermines basic policies underlying the Bankruptcy Code. The coerced loan approach allows secured creditors to recover profit and overhead, items which secured creditors are not entitled to recover under § 1325(a)(5)(B)(ii) and which in some cases is higher than in others due to the creditor's own risk taking and inefficient business practices. This approach is creditor specific, meaning that similarly situated secured creditors are not treated equally. It can produce a result that allows a secured creditor to receive more than the present value of its allowed secured claim at the expense of the other creditors in the case which results in unfair discrimination among creditors. Finally, it is not efficient or practical in the context of Chapter 13 case administration.

This Court should instead adopt a "formula approach" to determine present value such as adopted by the Second Circuit in *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997). In *Valenti*, the Second Circuit concluded that the present value component of an allowed secured claim should be fixed at the Treasury Rate for the comparable repayment schedule under the debtor's plan plus a premium of one to three percentage points to reflect the creditor's risk in receiving

deferred payments. The Treasury Rate is the most appropriate rate to use in determining "value, as of the effective date of the plan," because it includes some components of interest that comprise a discount rate, or present value, such as inflation and liquidity, but does not include the interest components to which a creditor is not entitled such as profit, default, or risk premiums. Utilizing the Treasury Rate fulfills the statutory requirements and advances the policies of the Bankruptcy Code by paying a secured creditor that to which it is entitled and promoting fairness among creditors. Unlike a creditor specific rate, this rate is simple and efficient to compute.

In the event that this Court rejects a formula approach utilizing the Treasury Rate but instead decides to utilize a coerced loan approach, this Court should consider the Sixth Circuit's ruling in *In re Kidd*, 315 F.3d 671 (6th Cir. 2003) which held that the interest rate a secured creditor should receive under § 1325(a)(5)(B)(ii) is "the current conventional market rate for similar loans in the region, and not necessarily the contract rate." Although the *Kidd* court's coerced loan approach is subject to many of the same criticisms as the coerced loan approach of other courts, the Sixth Circuit has at least introduced some sense of equality between similarly situated creditors by rejecting a "market rate" dictated by a particular creditor.

ARGUMENT

I. STATUTORY CONSTRUCTION OF THE BANKRUPTCY CODE ARGUES AGAINST USING A CREDITOR'S CONTRACT RATE OF INTEREST TO CALCULATE THE PRESENT VALUE OF AN ALLOWED SECURED CLAIM UNDER 11 U.S.C. § 1325(a)(5)(B)(ii).

A. The Plain Language of 11 U.S.C. § 1325(a)(5)(B)(ii) Does Not Require the Payment of a Creditor's Contract Rate of Interest.

A Chapter 13 debtor may propose a plan that provides for an allowed secured claim in one of three ways. First, a secured creditor may accept the plan's proposed treatment of the allowed secured claim thereby relieving the debtor from obtaining court approval of the treatment of that creditor's claim. 11 U.S.C. § 1325(a)(5)(A). Second, a Chapter 13 plan may propose to surrender collateral back to a secured creditor, thus eliminating the secured claim. 11 U.S.C. § 1325(a)(5)(C). Third, the statute permits the debtor to propose, and obtain confirmation of, a plan over the creditor's objection, as long as the plan meets the requirements of 11 U.S.C. § 1325(a)(5)(B)(ii). This third method of providing for a creditor's allowed secured claim is the subject of this appeal. In *Till*, the Seventh Circuit ruled that absent persuasive evidence otherwise, the secured creditor's contract rate of interest plus replacement value of the collateral is presumptive of the value, as of the effective date of the plan, of property to be distributed under a Chapter 13 plan on account of the creditor's allowed secured claim as set forth in 11 U.S.C. § 1325(a)(5)(B)(ii). The NACTT submits, however, that the plain language of the statute, when

read with other sections and considered in light of the legislative history of the Bankruptcy Code, does not require the payment of a creditor's contract rate of interest on an allowed secured claim.

To ascertain the meaning of this statute, one should begin its analysis by examining the plain language of the sentences that comprise § 1325(a)(5)(B)(ii) of the Bankruptcy Code. *Patterson v. Schumate*, 504 U.S. 753, 757 (1992). The statute provides, in pertinent part:

> . . . [T]he court shall confirm a plan if . . .
>
> (5) with respect to each allowed secured claim provided for by the plan . . .
>
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
>
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; . . .

This Court ordinarily resists reading words or elements into a statute that do not appear on its face. *Bates v. U.S.*, 522 U.S. 23, 29 (1997). The provisions of the Bankruptcy Code, including § 1325(a)(5)(B)(ii), must be read *in pari materia* to ascertain their meaning. *See, e.g., United States Savings Ass'n v. Timbers of Inwood Forest*, 484 U.S. 365, 370-72 (1988); *Matter of Maddox*, 15 F.3d 1347, 1354 (5th Cir. 1994). Section 1325(a)(5)(B)(ii) does not contain the term "interest"

and this Court should not read that term into the statute. By contrast, Congress expressly authorized a fully secured creditor to collect "interest" as a part of its allowed secured claim under § 506 of the Bankruptcy Code which provides:

> To the extent an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, *interest on such claim*, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 506(b) (emphasis added). Again, Congress utilized the term "interest" in § 726(a) of the Bankruptcy Code, establishing the priority for distribution of property of the estate in a Chapter 7 case. Section 726(a) provides, "[F]ifth, in payment of *interest* at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection." 11 U.S.C. § 726(a)(5) (emphasis added).

This Court has previously ruled that where Congress includes particular language in one section of a statute but omits it in another section of the same act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion. *Bates*, 522 U.S. at 29-30 (citing *Russell v. United States*, 464 U.S. 16, 23 (1983)). Accordingly, where Congress included the term "interest" in §§ 506 & 726 but not in § 1325(a)(5)(B)(ii), this Court must presume that Congress did so purposefully. Based upon the foregoing, the NACTT submits that the plain language of § 1325(a)(5)(B)(ii), while requiring the payment

of the present value of a secured claim, does not require the payment of the contract rate of interest on a creditor's allowed secured claim.

B. The Legislative History Demonstrates that Congress Did Not Intend 11 U.S.C. § 1325(a)(5)(B)(ii) to Require the Payment of a Creditor's Contract Rate of Interest.

To the degree that the plain language of § 1325(a)(5)(B)(ii); *i.e.* "the value, as of the effective date of the plan," when read together with other sections of the Bankruptcy Code, does not explicitly resolve the matter, one should look to the legislative history of the Bankruptcy Code to give meaning to the statute. *See Matter of Maddox*, 15 F.3d at 1354. This legislative history further supports the position of the NACTT and the Appellant. Describing the effect of what was initially to be § 1129(a) under Chapter 11 of the Bankruptcy Code (another reorganization chapter), the House Committee Report states that the use of the concept of value "as of the effective date of the plan" requires analysis independent of simply searching for the contract interest rate. The original bill precluded confirmation of a Chapter 11 plan if distributions to a secured creditor exceeded the claim's value. The Report states:

> [1129(a)] contemplates a present value analysis that will discount value to be received in the future; of course, if the interest rate paid is equivalent to the discount rate used, the present value and the face future value will be identical. On the other hand, if no interest is proposed to be paid, the present value will be less than the face future value. For example, consider an allowed secured claim of $1,000 in a class by itself.

> One plan could propose to pay $1,000 on account of this claim as of the effective date of the plan. Another plan could propose to give a note with a $1,000 face amount due five years after the effective date of the plan on account of this claim. A third plan could propose to give a note in a face amount of $1,000 due five years from the effective date of the plan plus 6% annual interest commencing on the effective date of the plan on account of this claim. The first plan clearly meets the requirements of subparagraph (a) because the amount received on account of such claim has an equivalent present value as of the effective date of the plan equal to the allowed amount of such claim. The second plan also meets the requirements of subparagraph (a) because the present value of the five years note as of the effective date of the plan will never exceed the allowed amount of the secured claim; the higher the discount rate, the less present value the note will have. Whether the third plan complies with subparagraph (a) depends on whether the discount rate is less than 6%.

HR 95-598, September 8, 1997 95th Congress 1st Session, 350 (1977).

"Present value" is a concept "based upon the common sense notion that a dollar paid to you one year from now is less valuable to you than the dollar paid to you today." Frederick Mishkin, *The Economics of Money, Banking and Financial Markets* 69 (Addison Wesley 2001); *See* Paul A.

Samuelson, *Economics* 47-48 (McGraw-Hill Book Company, Inc. 1948). As the bankruptcy court in *In re Wilkinson*, 33 B.R. 933 (Bankr. S.D. N.Y. 1983) noted:

> "Present value" or the "time value of money" is not a legal concept, but rather it is a term of art in the financial community. It simply means that a dollar received today is worth more than a dollar to be received in the future. To compensate the creditor for not receiving its money today, the debtor is charged an additional amount of money. The charge is based on a rate of interest called "discount rate." The discount rate is used to calculate how much the creditor should be paid so it will have the same amount of money in the future as it would have had if it did not have to wait to be paid.

In re Wilkinson, 33 B.R. at 936, n.2. Concerning the "discount rate," it has been noted:

> [F]rom an economic perspective, the discount rate represents compensation for the time value of money. In effect, the discount rate is the price or exchange rate that is paid to compensate a lender who foregoes current spending or investment opportunities to make a loan. This compensation includes three components: (1) a real rate (the basic rate established by the demand for borrowing and the supply of capital to compensate for the mere passage of time, without taking into account expected inflation or risk); (2) an expected inflation rate (to compensate for the

> expected loss in purchasing power); and (3) a risk premium (to compensate for the uncertainty regarding the actual return).

Dean Pawlowic, *Entitlement to Interest Under the Bankruptcy Code*, 12 Bankr. Dev. J. 149, 174 (1995).

"Interest," on the other hand, has been said to represent "the price of the use of money." Samuelson, 303. Interest can include the expected rate of inflation, the riskiness of the borrower, the liquidity of the borrowing investment, and the time to maturity. Stanley G. Eakins, *Finance: Investments, Institutions & Management* 77 (Addison Wesley 1999). Interest is composed of profit, administrative costs, risks, industry transaction costs, costs of collection, and other elements. It has been observed that interest is composed of "(1) pure interest, (2) an inflation premium, (3) a default premium, (4) a liquidity or market ability premium, and (5) a maturity or risk premium." *In re Smith*, 178 B.R. 946, 954 (Bankr. D.Vt. 1995); *See also* J. Fred Weston and Eugene Brigham, *Essentials of Managerial Finance* 10th Edition (1990). These contractual rights are subject to modification under all reorganization chapters of the Bankruptcy Code, including Chapter 13. See §§ 1123(b)(1), 1222(b)(2) & 1322(b)(2).

Based upon statutory construction principles and the legislative history of the Bankruptcy Code, Congress clearly did not intend to require the payment of "interest" or "contract interest" on allowed secured claims under a Chapter 13 plan. Congress instead required that the plan provide to pay the present value of the claim. By distinguishing between "present value" and "interest," Congress recognized that the two concepts are different and that "interest" includes various

components that are not included in "present value" or "discount factor." Congress understood and used the term "interest"in sections of the Bankruptcy Code where it decided interest was required to be paid as in §§ 506(b) and 726(a)(5). Congress, however, did not include the requirement that "interest" be paid on allowed secured claims pursuant to § 1325(a)(5)(B)(ii). Congress simply required the secured claim be paid its present value.

C. The Seventh Circuit's Construction of 11 U.S.C. § 1325(a)(5)(B)(ii) Conflicts With Other Statutory Provisions of Chapter 13 Title 11 U.S.C. and Major Policy Considerations Underlying the Bankruptcy Code.

Construing § 1325(a)(5)(B)(ii)'s "value, as of the effective date of the plan" to mean a creditor's contract interest rate instead of "present value," the Seventh Circuit in *Till* creates a conflict between that statute and other provisions of the Bankruptcy Code equally applicable to Chapter 13 cases. For example, a Chapter 13 plan that allows a creditor to receive "interest" on its allowed secured claim where the interest rate exceeds "present value" violates the basic policy of bankruptcy law that "equity is equality" and that creditors with similar claims should be treated similarly. As observed by the Sixth Circuit Court of Appeals in *In re Kidd*, "to permit a secured creditor to receive interest on his claim in an amount greater than the conventional market rates would allow the creditor to actually receive more than the allowed amount of his secured claim." *In re Kidd*, 315 F.3d 671, 677 (6th Cir. 2003). In a Chapter 13 case, if a secured creditor receives a greater distribution towards its allowed secured claim, then it is actually receiving a distribution on account of its allowed unsecured deficiency

claim. In this situation, the creditor's unsecured claim (the deficiency remaining after application of 11 U.S.C. § 506) is being paid amounts in addition to the dividend to all general unsecured creditors resulting in unfair discrimination violating § 1322(b)(1). Also, as will be shown below, the application of *Till* to a typical Chapter 13 case creates creditor specific interest rates, as opposed to present value, resulting in disparate treatment of secured creditors within the same class further violating the basic bankruptcy policy of treating similarly situated creditors equally.

II. THE "FORMULA" APPROACH IS THE BEST METHOD FOR DETERMINING PRESENT VALUE UNDER 11 U.S.C. § 1325(a)(5)(B)(ii).

A. Confusing Interest with Present Value: The Origins of the Coerced Loan Approach.

It is true that some federal courts, like economists, confronted with the need to determine if a plan has met its obligation to pay the present value of secured claims have resorted to using the term "interest" as convenient shorthand for "present value." As noted above, however, interest in a contract is not the same as present value. This process of confusing "interest" with "present value" has apparently been traced to a leading treatise: *Collier on Bankruptcy* in a comment at 5 *Collier on Bankruptcy*, ¶ 1129-03, pp. 129-99, 15th ed. (1994). *See In re Computer Optics, Inc.*, 126 B.R. 664,671 (Bankr. D. N.H., 1991); *In re Smith*, 178 B.R. 946, 951 (Bankr. D.Vt. 1995)(modif'd, on other grounds,

In re Valenti, 105 F.3d 55 (2nd Cir. 1997)). At least two bankruptcy courts have stated:

> Without citing any case or other authority that existed at the time, the Collier treatise in that comment took a quantum leap from the present value concept in terms of the time value of money into a totally different concept of a loan transaction involving fact specific risk analysis.

Computer Optics, 126 B.R. at 671; *Smith*, 178 B.R. at 951 (citing *Computer Optics*). "Simply put, *Collier* confused loans and claims." *Id*. "As a result, judges have been functioning as commercial loan officers, economists, and financial managers in their opinions, and not as the overseers of the reorganization process." *Smith*, 178 B.R. at 951.

Colliding apples with oranges, in their attempts to create an interest rate that satisfies the present value requirement of § 1325(a)(5)(B)(ii), the courts have engaged in "a grueling exercise in self-impalement on concepts taken out of context. It has been observed that the attempt to award interest equivalent to the market rate for similar loans is doomed to produce chaos and confusion . . . because it starts with legal concepts that do not apply." *In re Smith*, 178 B.R. at 951.[6] The attempt has spawned a myriad of mutually exclusive approaches producing rates that could never be found in the market such as the "coerced loan" theory — that a secured

6. Judge Conrad's decision in *In re Smith* was subsequently modified as a result of the Second Circuit's decision in *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997) but the reasoning of Judge Conrad's opinion and its sound footing on statutory construction are well founded.

claim is to be treated as a new, albeit involuntary, loan and "present value" has transformed into "contract interest." *Id*. But, as has been noted, a "claim," under the Bankruptcy Code, is a right to payment and a "loan" under applicable non-bankruptcy law, is a contractual obligation which often includes the requirement to pay interest. *Smith*, 178 B.R. 951. "The obligation to pay interest on a claim, by contrast, is statutory, not contractual, and the amount of interest should be determined by reference to the appropriate statute, not the contract or market." *Id*.

The Courts of Appeals for the Third, Fourth and Fifth Circuits have extended the "current market rate" approach to provide that the rate of interest that a particular secured creditor would charge for a new loan similar in character, amount, and duration would be applicable in a Chapter 13 case. *General Motors Acceptance Corporation v. Jones* (*In re Jones*), 999 F.2d 63 (3rd Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993); *Matter of Smithwick*, 121 F.3d 211 (5th Cir. 1997). As noted by the Third Circuit in *Jones*, the application of this creditor's contract rate seeks to put the secured creditor in an economic position equivalent to one it would have occupied had it received its allowed secured claim amount immediately. *Jones*, 999 F.3d at 67. The "coerced loan theory" is, in fact, a "market rate" that is not based on any "market" but is rather based solely upon what a particular creditor has contractually secured from a debtor.

In *Till*, the Seventh Circuit has followed the coerced loan theory and arrived at the conclusion that a creditor's contract rate of interest, absent persuasive evidence otherwise, plus the replacement value of its collateral is presumptive of the "value, as of the effective date of the plan," of property to be

distributed under a Chapter 13 plan on account of the creditor's allowed secured claim as set forth in 11 U.S.C. § 1325(a)(5)(B)(ii). *In re Till*, 301 F.3d 583, 592-93 (7th Cir. 2002).

The Sixth Circuit, in *In re Kidd*, 315 F.3d 671, 678 (6th Cir. 2003), has also recently adopted the "coerced loan theory." In determining the interest rate that the secured creditor should receive for making the coerced loan, however, the *Kidd* court concluded that the proper interest rate to be applied under § 1325(a)(5)(B)(ii) is "the current conventional market rate for similar loans in the region, and not necessarily the contract rate." *Kidd*, 315 F.3d at 678. In so doing, the Sixth Circuit introduced some sense of equality between like creditors and rejected a "market rate" dictated by a particular creditor.

B. The Results of the Confusion and the Coerced Loan Approach: Inequitable Treatment of Creditors and Undermining of Bankruptcy Policy.

The creditor based approaches of the various "coerced loan" theories, as noted by a leading Chapter 13 treatise, "are nightmares of logic and application." Keith M. Lundin, *Chapter 13 Bankruptcy*, 3rd Ed. 112-9(2002). In his treatise, Judge Lundin observes:

> Nothing in § 1325(a)(5)(B)(ii) suggests that "value, as of the effective date of the plan" is a creditor specific concept. If present value varies from creditor to creditor depending on facts specific to each creditor's financial condition,

> management and lending practices, then the interest rate at confirmation in a Chapter 13 case will be different with respect to every claim, with respect to every creditor, with respect to every day and all the relevant evidences proprietary to the holder of the secured claim. It is not imaginable that Congress intended "value, as of the effective date of the plan" to mean that inefficient, poorly managed lenders get higher interest rates than well managed, better capitalized lenders.

Id.

Contract rate or creditor specific rates effect a basic imbalance in the structure of a reorganization. Following creditor specific coerced loan rates and ignoring the congressional mandate that a claim only be paid its "present value" will lead to the anomalous determination that an efficient creditor with appropriate and accurate lending policies who is well capitalized with access to a broad market for funds will receive *less* in a Chapter 13 plan than an inefficient, sub-prime or predatory lender who, by receiving its higher contract rate of interest for its allowed secured claim, is being compensated for poor credit decisions and inefficient or ineffective operations. In essence, the efficient creditors would be subsidizing the inefficient sub-prime market predatory lenders. Indeed, no bankruptcy policy is served by establishing varying interest rates that Chapter 13 debtors have to pay based upon a creditor's efficiency, or lack thereof. *Smith*, 718 F.3d at 952.

The principles of equality are shattered by applying a creditor-unique contract interest rate to determine the present value factor added to the value of collateral in a Chapter 13

case. A simple example, often seen in Chapter 13 cases, is illustrative:

> A family has financed three identical automobiles and has proposed in a Chapter 13 plan to pay the creditors, with liens on the cars, the present value of the cars. Assume the replacement value of this type of automobile is $15,000. One is financed by a subprime lender, with a contractual interest rate of 23% per annum, one is financed by a conventional and efficient lender charging 7% per annum, and one is offered either at a "we tote the note" used car dealership (which does not include interest on its financing, making up for that source of income by establishing a significantly higher purchase price for the vehicle) or sold with a "zero percent financing" (a lower interest rate established for marketing on other purposes). If contract rate were to control, these three claims would be paid over 48 months at $480.77 per month, $359.19 per month, and $312.50 per month and the creditors would be paid $23,076.96, $17,241.12, and $15,000 respectively, even though each creditor has identical collateral of identical value, all subject to the same bankruptcy proceeding initiated by the same debtor.

Applying *Till* to the statutory scheme of the Bankruptcy Code, a secured creditor's inefficient lending practices would not simply be a cost born by the efficient secured creditors in a Chapter 13 case; but the unsecured creditors would have to pay for it as well. Under § 1325(b), a debtor is obligated to pay all disposable income to fund a Chapter 13 plan.

The debtor's disposable income paid to the trustee over the plan life creates a fixed pool of funds that the trustee can distribute to all creditors. As shown by the typical Chapter 13 case illustration above, to the extent an inefficient or sub-prime high interest rate lender is entitled to receive a greater claim than an efficient and careful creditor, the inefficient creditor receives a greater portion of the pool of funds. The general unsecured creditors will receive less of these funds and ultimately bear the cost of the inefficient creditor. Again, this result runs counter to bankruptcy policy, here, because it creates an inequity in the distribution available assets or income.

Applying *Till* to the case illustration also shows that cases involving the "tote the note" or "0% financing" seller whose contract is 0%, absent persuasive evidence to the contrary, would result in a Chapter 13 plan paying no interest to such a creditor. Clearly, under such a Chapter 13, this creditor is not getting the present value of its allowed secured claim because the money paid to the creditor over the plan life is not the same as if the full amount of the allowed secured claim were paid to that creditor today. HR 95-598, September 8, 1997 95th Congress 1st Session, 350 (1977). Oddly, under *Till*, the evidentiary presumption of the burden of proof shifts from the debtor to the creditor in this situation; i.e. if the contract rate is in excess of present value, the presumption favors the creditor and the burden is on the debtor to establish persuasive evidence to the contrary, on the other hand, if the contract rate is lower than present value, the burden is on the creditor to establish persuasive evidence to the contrary.

A secured creditor is entitled to receive the present value of its allowed claim and nothing more. The concepts of administrative overhead, profit, liquidity of the underlying

obligation, and the numerous other factors that cause contract interest rates to exceed a simple present value should be excluded from determining the amount that must be paid on a secured claim. Under § 1325(a)(5)(B)(ii), a creditor is entitled to its present value; a creditor is not entitled to its profit, overhead, or other factors such as may be extorted from sub-prime borrowers. The "coerced loan" theories grant secured creditors "value" in excess of the amount authorized by the Bankruptcy Code and undermine the policies underlying the Bankruptcy Code and, therefore, this Court should reject those theories, adopted by the Seventh Circuit in *Till*.

C. A "Formula Rate" Utilizing the U.S. Treasury Rate More Accurately Represents Present Value Than the "Coerced Loan" Approach.

A "formula rate" utilizing the U.S. Treasury Rate appears to have its judicial genesis in *In re Smith*, 178 B.R. 946 (Bankr. D.Vt. 1995). In *Smith*, the bankruptcy court determined that the Treasury Rate, without any premium or "kicker," which best matches the maturity of an over-secured creditor's claim, is an appropriate present value factor in a Chapter 12 case. *Id.* at 956. At the beginning of its discussion in *Smith*, the court explains that it is looking for an honest interest rate that will further the goals of the bankruptcy reorganization while giving the secured creditor the protection to which it is entitled; an interest rate which is not too high or too low but is "just right." *Smith*, 178 B.R. at 949. Ultimately reaching its conclusion, the court states that the Treasury Rate for an instrument of similar term, while slightly overcompensating the secured creditor, comes as close as one can get in an imperfect economic's world to an interest rate that is just right for purposes of determining

"value, as of the effective date of the plan" in a Chapter 12 case. *Id.* at 953. The Treasury Rate is the most appropriate rate as opposed to other rates because it includes some components of interest that comprise a discount rate, or present value, such as inflation and liquidity, but does not include the interest components to which a creditor is not entitled under the Bankruptcy Code such as profit, default, or risk premiums. *Id.* at 954-55. Additionally, the *Smith* court notes that the Treasury Rate even provides the secured creditor with a discount "kicker" because the Treasury Rate contemplates payments on a six month or annual basis whereas payments in a typical bankruptcy repayment plan are made monthly. *Id.* at 956.

In *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997), the Second Circuit adopted a modified version of the *Smith* court's formula rate. In reviewing a decision from the District Court for the Northern District of New York, the *Valenti* Court ruled that the appropriate present value factor under § 1325(a)(5)(B)(ii) should be fixed at the Treasury Rate for the comparable repayment schedule under the debtor's plan plus a premium from one to three percent to reflect the creditor's risk in receiving deferred payments. *Valenti*, 105 F.3d at 64. If the parties are not able to stipulate, or agree, as to this risk premium, then the bankruptcy court should conduct a hearing limited solely to a determination of that premium. *Id.* In reaching its decision, the Second Circuit, noted that full payment of an allowed secured claim under § 1325(a)(5)(B)(ii) *includes* a present value component. *Valenti*, 105 F.3d at 63. A creditor who receives present value is placed in the same position that it would have been in had it received the value of its collateral on the date that the Chapter 13 plan was confirmed. *Id.* The *Valenti* court also

observed that courts adopting the coerced loan approach had held that the appropriate interest rate should include the creditor's profit that would have been generated had the value of the collateral been received immediately. *Id*. The *Valenti* court, however, concluded that a creditor's allowed secured claim does not include any degree of profit on its discount rate. *Id*. at 64. If the creditor received the profit component of its contract interest rate, it would receive more than the present value of its allowed claim. *Id*.

The *Valenti* court actually found that the "cost of funds" approach (determining the applicable interest rate based upon the rate that the creditor itself pays to borrow funds) may more accurately represent present value than the Treasury, or formula, rate, and certainly more accurately than the "coerced loan" rate. *Id*. The court rejected this approach, however, because it is expensive and inefficient for bankruptcy courts to administer and because the creditor-specific based rate inequitably treats debtors depending upon how much their respective creditors have to pay to borrow funds. *Id*.

Subsequent to the Second Circuit's decision in *Valenti*, the Bankruptcy Court for the District of Vermont issued another decision on the issue in *In re Vessico,* 227 B.R. 352 (Bankr. D. Vt. 1998). In *Vessico*, the bankruptcy court questioned the *Valenti* court's imposition of a risk premium in addition to the Treasury Rate in light of this Court's subsequent decision in *Associates Commercial Corporation v. Rash*, 520 US 953 (1997). *Vessico*, 227 B.R. at 355. In *Rash*, this Court recognized that the risk of default is a factor to be encompassed in the determination of value under § 506. *See Associates Commercial Corporation v. Rash*,

520 US 953, 963 (1997). Accordingly, in light of this Court's decision in *Rash*, it may not appropriate to burden the "present value" factor with the entire risk of default.

Based upon the foregoing, a formula rate, consisting of the Treasury Rate for an instrument with a maturity equivalent to the repayment schedule under the debtor's plan plus a risk premium of one to three percentage points as determined by the parties through agreement or by the bankruptcy court as trier of fact, is the rate that best represents the "interest rate" or "present value" to compensate the secured creditor for the "value, as of the effective date of the plan" under § 1325(a)(5)(B)(ii). As much as possible, this rate puts the creditor in the same position as if it had obtained the full amount of its allowed secured claim as of the date of a Chapter 13 plan's confirmation by providing for the components of interest such as inflation, liquidity and risk. The formula treats similar creditors in a plan similarly. Furthermore, this formula rate does not compensate the secured creditor for those components of interest to which it is not entitled under the Bankruptcy Code such as profit, recovery of overhead and inefficient lending practices. The rate is simple and efficient to compute allowing the parties and bankruptcy courts to focus their limited resources on other issues such as plan feasibility and claim valuation. Ultimately, this formula rate advances the policies of the Bankruptcy Code by fulfilling the statutory requirements, paying the secured creditor the amount to which it is entitled, while, at the same time, allowing the debtor the opportunity to reorganize under a Chapter 13 plan whose feasibility is not jeopardized by requiring the debtor to pay excessive amounts of interest and treating creditors within the same class equally.

CONCLUSION

For the reasons set forth in this *Amicus Curiae* Brief, the NACTT supports the position of the Petitioners and respectfully requests that this Court reverse the Seventh Circuit's decision in *Till* that a creditor's contract rate of interest, absent persuasive evidence otherwise, together with the replacement value of the creditor's collateral, is presumptive of the value, as of the effective date of the plan, of property to be distributed under a Chapter 13 plan on account of the creditor's allowed secured claim as set forth in 11 U.S.C. § 1325(a)(5)(B)(ii). This Court should instead adopt a "formula approach" to determine present value; specifically, the present value component of an allowed secured claim should be fixed at the Treasury Rate for the comparable repayment schedule under the debtor's plan plus a premium of one to three percentage points to reflect the creditor's risk in receiving deferred payments. Utilizing the Treasury Rate fulfills the statutory requirements while advancing the policies of the Bankruptcy Code by paying a secured creditor that to which it is entitled and promoting fairness among creditors. In the event that this Court rejects a formula approach utilizing the Treasury Rate, this Court should consider establishing the present value component as "the current conventional market rate for similar loans in the region, and not necessarily the contract rate" which in the NACTT's position is not preferable to the formula approach but at least introduces some sense of equality between like creditors by rejecting a "market rate" dictated by a particular creditor.

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Petitioners,

v.

SCS CREDIT CORP.,

Respondent.

On a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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INTEREST OF AMICUS CURIAE

In the last year alone, more than 1.6 million American families filed for bankruptcy. A growing number of those families—unable to avoid the financial devastation of lay-offs, illness or divorce—include men and women age 50 or older. They are now the fastest-growing group in bankruptcy. AARP is a nonpartisan, nonprofit organization dedicated to representing the interests of older Americans. As *amicus*, it periodically has provided the Supreme Court with the perspective of its 35 million members.[1]

The significance of this case, particularly for older Americans, lies just below its surface. Like the U.S. Courts of Appeal, the principal parties disagree over the appropriate rate of interest for individual secured creditors under 11 U.S.C. § 1325(a)(5)(B)(ii). This is not simply a creditor-debtor dispute, however, about the interpretation of an arcane provision of consumer bankruptcy law. Rather, the case tests the very integrity of the Bankruptcy Code in Chapter 13, its balance and its effectiveness.

Lee and Amy Till are debtors. SCS Credit Corporation is a creditor, having lent the Tills the money to buy a truck that, in turn, collateralizes the loan. In deciding their case, this Court necessarily will ask whether Congress intended to provide a significant benefit to one creditor at the literal expense of every other creditor. It also will decide whether Chapter 13 provides an efficient and effective procedure for families to save their homes and cars, pay at least some of their debts, and rehabilitate themselves financially without resorting to liquidation in Chapter 7.

The growing economic vulnerability of older Americans is a national tragedy. The rate of bankruptcy filings, hitting

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[1] Each party's written consent for the submission of this brief is on file with the Clerk of the Court. Pursuant to Rule 37.6, AARP states that no counsel for any party authored this brief in whole or in part and that no party or entity other than AARP, its affiliates, or counsel made a monetary contribution to the preparation or submission of this brief.

new records each year, is rising faster among those 55 and older than the general population. Eighty percent of older families own their own homes and, faced with a financial crisis, they increasingly turn to Chapter 13 to save them.

Only in Chapter 13 can a family keep its home by paying any amount past due, curing that arrearage over time, and continuing regular payments at the mortgage rate of interest. The statute also requires, however, that the family pay all of its non-mortgage secured debt (based on the collateral's actual value) and commit all of its disposable income, after necessary living expenses, to unsecured creditors. The higher the rate of interest on that non-mortgage debt, the less a family has to sustain the mortgage and pay its other creditors pro-rata. Without those payments, a plan can neither be approved by the court nor, if approved, sustained.

For many older Americans, the financial margin is this thin, the choice is this stark: they can afford the mortgage and make reduced payments to all of their creditors, or they can pay a few creditors the full subprime interest rates on a car loan and collateralized consumer purchases. Since they cannot do both, the loss of their homes may well become inescapable.

The decision by the U.S. Court of Appeals for the Seventh Circuit means, quite simply, that fewer older Americans will be able to qualify for the bankruptcy law's protection with fewer still able to complete a plan of financial rehabilitation that leaves them with a home or a reserve for retirement or failing health. The Seventh Circuit's decision also means that a few secured creditors can demand subprime interest rates, even at predatory heights, through the three to five years of a Chapter 13 plan—not leaving enough either for mortgage payments or for other creditors.

Not only are older Americans most likely to want, to need, to save the homes they have, they are often on fixed or limited incomes with little prospect for significant increases.

Not surprisingly then, "[s]ubprime borrowers are more likely to be older than prime [rate] borrowers." U.S. Department of Housing and Urban Development, *HUD-Treasury Report 36*, at http://www.hud.gov/library/bookshelf18/pressrel/treasrpt.pdf (2001). For them, the rate of interest on secured (non-mortgage) debt in Chapter 13 may well determine their financial future. Amy and Lee Till are not yet 50. While the decision here will affect all debtors, AARP joins the Tills because its membership has more at risk in this case than any other age group.

In the Bankruptcy Code, Congress has guaranteed that creditors will receive the "value, as of the effective date of the plan," of their collateral whenever a Chapter 13 debtor elects to keep the family's car, mobile home, or appliance. Congress has not, however, promised some secured creditors more money than any other creditor *in* bankruptcy through the simple expedient of charging more interest *before* bankruptcy. The issue presented here is particularly important to AARP members not only because they often pay the highest interest rates but because the balanced protection Congress provides debtors and creditors in the federal bankruptcy law has heightened importance for older Americans.

SUMMARY OF ARGUMENT

In 1938, in the shadow of the Great Depression, Congress passed the Chandler Act to give American families facing financial disaster a choice. They could file a bankruptcy petition under Chapter 7, obtaining a discharge of some of their debt at the cost of liquidating all of their non-exempt assets and distributing the proceeds to creditors, or they could take advantage of a new procedure, Chapter 13. It enables families to save their homes by paying at least some of their debts under a three to five year plan, discharging the balance of their obligations upon the

completion of the plan. That statutory choice remains available today.

Congress has encouraged families to elect Chapter 13 by, systematically, providing incentives unavailable in Chapter 7. While more families still use Chapter 7, often because they have few if any unencumbered assets to protect, Chapter 13 helps families trying to keep their homes, including the mobile homes owned by so many older Americans, their cars and other consumer goods subject to a security interest. Chapter 13 permits a family to keep its car or mobile home by making payments based on the asset's fair market value, rather than the loan's balance at the time of the bankruptcy. Under this provision, known as a "cramdown," the difference between the collateral's fair market value and the outstanding loan becomes an unsecured debt.[2] The debtor pays a portion of that unsecured debt pro-rata, over time, with all of his or her other unsecured debt under a Chapter 13 plan.

Lee and Amy Till borrowed $6,425.00 in 1998 to buy a used truck. They agreed to pay 21 percent interest, a rate generally characterized as "subprime." By the time they filed for bankruptcy, the value of the truck had declined to $4,000.00, less than the loan balance. SCS Credit Corp., which held a perfected security interest in the truck, objected to the Tills' proposed Chapter 13 plan. To enable them to keep the truck, the three-year plan called for a 9.5 percent interest rate on the truck's value: a 1.5 percent risk premium added to the then-prime rate of eight percent. Objecting to the plan, SCS asked the court to apply the contract rate.

This case presents a single issue: What is the appropriate rate of interest under 11 U.S.C. § 1325(a)(5)(B)(ii) due the creditor on the debtors' payments for the *secured* "value" of

[2] This Court first noted the descriptive phrase in *St. Joe Paper Co. v. Atlantic Coast Line R. Co.*, 347 U.S. 298, 314-15 (1954), applying the Bankruptcy Act of 1935 to permit the approval of a reorganization plan despite the protests of "recalcitrant dissenters."

its loan? The Seventh Circuit in a 2-1 decision, disagreeing with the bankruptcy court, chose 21 percent, the contract rate, the highest rate. The court's majority was wrong.[3]

Congress has not authorized any court either to require that a debtor's plan presumptively use the contract rate of interest or to permit different secured creditors to collect the widely disparate amounts inevitable under either contract rate or market-based rate standards. Section 1325(a)(5) requires that the plan give the creditor "the value, as of the effective date of the plan, of property to be distributed under the plan ...." Nothing less, nothing more. In imposing the contract interest rate, the Court of Appeals exceeded its authority.

Since 1984, the bankruptcy law has required that all of a Chapter 13 debtor's disposable income be distributed to creditors. The decision by the Court of Appeals does not mean the debtor will have more or less available to spend—*all* of his or her disposable income must go to creditors in any case—but it does mean that a subprime creditor will receive relatively more than every other creditor.

In bankruptcy, both secured and unsecured creditors lose rights and money. To be sure, Congress establishes priorities in the Bankruptcy Code, determining the order in which debts are paid and whether in whole or in part. The law generally treats creditors similarly by classification: secured (non-mortgage) creditors receive the value of their collateral, and unsecured creditors are paid pro-rata from the remaining disposable income. A decision to permit some companies, most often those that finance car and mobile home loans, to be paid a larger share of their claims than any other creditor is not a decision Congress has made.

Had Congress intended to give each secured creditor a contract or market-based rate of interest for its Chapter 13

[3] While the Seventh Circuit characterized this "old contract rate" as the "presumptive rate," *In re Till*, Petitioners' Appendix, p. 20a, few debtors will be able to marshal the expert testimony and resources to rebut it.

claims, then it would have stated so specifically. Congress has done that often enough in other sections of the Bankruptcy Code, but *not* in section 1325.

The Code has been designed to treat legally similar creditors equally, to give debtors the opportunity for a fresh start, and to favor Chapter 13 over Chapter 7. The Seventh Circuit's decision collides with each of these fundamental principles. The majority's "coerced loan" theory presumptively adopts the contract rate of the loan, from a "bargain" struck perhaps years earlier, as the amount this creditor would charge were it to make a new loan. That overcompensates subprime creditors by awarding them full profit on their secured claims, even through bankruptcy, when every other creditor receives less (except, of course, where Congress has provided otherwise).

Three U.S. Courts of Appeal have declined to adopt the "coerced loan" theory that sustains subprime interest rates. *See GMAC v. Valenti (In re Valenti)*, 105 F.3d 55 (2d Cir. 1997); *Farm Credit Bank of Spokane v. Fowler (In re Fowler)*, 903 F.2d 694 (9th Cir. 1990); *United States v. Doud*, 869 F.2d 1144 (8th Cir. 1989). Instead, they have used a variable formula designed to give creditors the time value of the money to be repaid plus a premium for the risk perceived in the subprime loan. While this approach objectively recognizes the delayed value of a secured loan and eliminates differential treatment among secured creditors, it suffers from the same fatal flaw as the Seventh Circuit's decision: there is no Congressional authority for it.

Section 1325, by its own terms, compensates creditors for the value of the property at the time of the plan's confirmation. It does not compensate creditors for making a "new" loan, for overhead, for profits or for risks pre- or post-bankruptcy. The "value, as of the effective date of the plan"—that is, the total amount to be paid by the debtor in installments—necessarily is nothing more than interest over the life of the plan that protects the secured creditor against

inflation. The best measure of that interest is the rate paid by the U.S. Treasury on its obligations. Congress has authorized no other rate, and neither should this Court.

ARGUMENT

The practical consequences of this decision will be significant and widespread. Subprime lending has become pervasive: nearly 60 percent of American families hold loans that meet the term's definition.[4] *See* New Media Auto Services, Inc., *"Sub Prime" Lending*, *at* http://www.carinvoices.com/financing/about_financing/sub_prime_credit.htm (1999). On August 1, 2003, the published Treasury bill rate was 1.12 percent. That same day, the prime rate was 4.0 percent, the average was 6.14 percent for a 30-year, fixed-rate home mortgage and the average 60-month used car or truck loan was available at 5.6 percent interest.[5]

The difference in interest rate is often decisive. At today's average vehicle loan rate—not the 21 percent in the Tills' contract—the debtor would have available $1,900 more over five years given the stipulated value of the Tills' used truck. The time value of money standard (measured at the Treasury bill rate) would free up almost $2,400. For many families reorganizing in Chapter 13, the additional amount available to pay creditors might well be the difference between saving and losing their homes: it will, in

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[4] A subprime lender extends "credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers." Federal Deposit Insurance Corporation, *Office of Inspector General, Audit Report No. 03-019*, p. 1 n.1, *at* http://www.fdic.gov/oig/a-rep03/03-019.pdf (March 18, 2003).

[5] *Weekly Mortgage Market Survey*, *at* http://www.freddiemac.com/learn/cgi-bin/dlink.cgi?jp+/PMMS/display/PMMSOutputyr.jsp&ENV=PROD (accessed Aug. 8, 2003); Moneycafe.com, *Rate, Definition & Historical Graph*, *at* http://www.nfsn.com/library/primehtm (Aug. 13, 2003).

many cases, enable their plans to be confirmed and completed.[6]

The Seventh Circuit erred in construing section 1325 as an entitlement, awarding each secured creditor its own pre-petition contract rate of interest. Nowhere in that provision or its legislative history does Congress state or even imply that creditors that have a car, mobile home, or any other collateralized consumer purchase as security are entitled to disparate contract rates of interest. The decision reflects a fundamental misunderstanding of the Bankruptcy Code.

I. SECTION 1325 DOES NOT PROVIDE FOR EITHER A CONTRACT OR A MARKET-BASED RATE OF INTEREST.

In Chapter 13, a secured creditor is entitled to the "value" of the property in which it asserts an interest up to the "allowed amount" of its claim. The allowed amount of a secured claim is the fair market replacement value of the security on the date of the debtor's plan confirmation.[7] Chapter 13 permits the debtor to keep the property by paying that "value" in installments—compensating the creditor for the time value of the money.

A. Congress Has Given The Bankruptcy Courts Sweeping Discretion To Modify Contract Terms.

Congress did not establish a fixed rate of interest to determine value over time. Instead, in 11 U.S.C. § 1322, it generally authorized the wholesale modification of the rights of all creditors, specifically permitting the courts to "modify the rights of holders of secured claims."

[6] Even where the plan could be completed at the subprime contract rate, the family's other creditors would lose their pro-rata share of the additional $2,400 that would go to the subprime truck lender alone.

[7] In *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 960 (1997), this Court held that the collateral itself should be valued in a Chapter 13 plan at its replacement cost.

> With respect to claims secured by any property other than a principal residence, this very significant power allows debtors to change contract terms by altering interest rates and monthly payments, by changing the length of the repayment period, by changing the total amount to be repaid and by modifying acceleration and default provisions.

2 Keith M. Lundin, CHAPTER 13 BANKRUPTCY § 104.1, at 104-1 (3d ed. 2002).

The courts have the discretion to modify the pre-petition interest rate so long as the creditor, at plan confirmation, receives the present value of the collateral. "Under Chapter 13 a debtor may *modify* the rights of any secured creditor *except* one whose claim is secured only by a mortgage on the debtor's principal residence." *Shearson Lehman Mortgage Corp. v. Laguna (In re Laguna)*, 944 F.2d 542, 544 (9th Cir. 1991), *overruled on other grounds, Rake v. Wade*, 508 U.S. 464 (1993). That single statutory exception, for home mortgage lenders, is explicit in section 1322(b)(2).

Section 1322 generally permits a debtor's plan to modify all contract rights. Section 1325 limits that authority by guaranteeing a secured creditor the value of the collateral at confirmation. There are no other limits. There is no other guarantee.

"In determining the scope of a statute, we look first to its language. If [it] is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'" *Russello v. United States*, 464 U.S. 16, 20 (1983). With or without ambiguity, moreover, the cramdown provision of section 1325 necessarily will be read in the context of the Bankruptcy Code as a whole. *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988)

("*Timbers*"). The plain language of the statute and the rules of statutory construction compel the same conclusion here: Congress did not intend a contract or market-based rate of interest to apply in cramdowns.

B. Congress Has Expressly Declined To Specify A Contract Rate Of Interest For Secured Creditors Under Section 1325.

Not only is it evident, from the face of the statute, that Congress did not grant secured creditors their contract rate of interest, Congress has declined to enact a contract rate provision. Prior to the Bankruptcy Amendments and Federal Judgeship Act, P.L. 98-353, 98 Stat. 333 (1984), Congress had proposals expressly requiring that the contract rate of interest be paid in a Chapter 13 cramdown. *See* H.R. 1085, 98th Cong. § 19(2)(A) (1983); H.R. 1169, 98th Cong. § 19(2)(A) (1983); H.R. 4786, 97th Cong. § 19(2)(A) (1981). Among other things, the legislation sought to amend section 1325(a)(5)(B)(ii) to ensure that "the value, as of the date of filing the plan, of property to be distributed under the plan is not less than the value determined under section 506(b) of this title *and, if such value is to be paid in installments, interest is to be paid at the rate specified in the consumer's contract.*" *Id.* (emphasis added). Congress never adopted the legislation.

In *Russello*, this Court concluded that "[w]here Congress includes limiting language in an earlier version of a bill but deletes it prior to enactment, it may be presumed that the limitation was not intended." 464 U.S. at 23-24. Congress specifically considered requiring a contract rate of interest in cramdowns but chose not to mandate it. The statute's focus is on "value," as of the plan's effective date, and that can only mean the time value of money.

C. Congress Expressly Provided For Contract And Market-Based Rates Of Interest In Other Sections Of The Bankruptcy Code.

In several sections of the Bankruptcy Code, Congress expressly provided for a specific rate of interest. In 11 U.S.C. § 1322, governing home mortgages, for example, it prohibited bankruptcy courts from modifying the pre-petition rate of interest established by contract. In 11 U.S.C. § 506(b), Congress allowed oversecured creditors to obtain contractual fees, costs and charges throughout the bankruptcy proceeding. Congress knew very well how to ensure that contract or market conditions remain in force in bankruptcy, and it has required just that in a series of Code provisions. Section 1325, however, is not among them.

Home Mortgages

Congress has specifically directed bankruptcy courts to apply the pre-petition contract rate of interest to home mortgages. While bankruptcy courts have broad discretion to "modify the rights" of all creditors, they may *not* modify "a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2). This provision unequivocally "proscribes modification of the rights of a homestead mortgagee." *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 327 (1993). A debtor can avoid home foreclosure only by continuing to pay the original contract rate of interest. *Id.* at 331-32. This explicit statutory exception, of course, has another effect: *all* of the other "rights of holders of secured claims" remain subject to modification.

Had Congress intended to provide a contract rate of interest for all security agreements, section 1322(b)(2)'s exception would be superfluous. "It is 'a cardinal principle of statutory construction' that 'a statute ought ... to be so construed that, ... no clause, sentence, or word shall be superfluous, void, or insignificant.'" *TRW, Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (citation omitted). If Congress had

wanted a contract rate of interest to apply in non-mortgage cramdowns, it would not have used the language it did in section 1322(b)(2).

Home mortgages are an exception, the only exception, to the rule permitting the modification of the contract rate of interest in cramdowns. Despite that, the Seventh Circuit's decision in effect has granted car lenders and mobile home lenders the same extraordinary protection for their pre-bankruptcy contractual bargains—a guarantee Congress explicitly gave only to home mortgage lenders. Moreover, if *all* secured lenders received their contract rate, homeowners would have appreciably less available to pay the mortgage. The inevitable result: more foreclosures.

Significantly for AARP members, the Bankruptcy Code's home mortgage exception does *not* apply to mobile homes. The courts generally treat mobile homes as personal property (not realty) and, as such, mobile home lenders and borrowers are not bound to the contract rate of interest in cramdowns.[8] This heightens the impact of the decision in this case on mobile homeowners and, accordingly, on older Americans. In 2001, 2.5 million people age 50 and older owned mobile homes. These older homeowners occupied almost half of the nation's stock of owner-occupied manufactured housing. *See* AARP, *Issues in Manufactured Housing*, *at* http://research.aarp.org/il/fs16r_housing.html (May 2001).

Older Americans are particularly vulnerable to predatory lending in the manufactured housing market, where a high proportion of buyers have low incomes and fewer choices. *Id.* The median annual income for older Americans (50 and

[8] *See In re Enewally*, 276 B.R. 643, 646 n.4 (Bankr. C.D. Cal. 2002) ("[S]tatutory exception [§ 1322(b)(2)] does not apply to a debtor's principal residence if that residence is a mobile home."); *Homeowners Funding Co. v. Skinner*, 129 B.R. 60, 64 n.2 (E.D.N.C. 1991) ("[M]obile home is personal property, not real property, and therefore the prohibition against modification" does not apply.).

over) who own manufactured housing was $20,000. By contrast, it was $34,000 for older Americans (50 and older) who own conventional single-family housing. *Id.*

Older Americans constitute an ever growing and disproportionately large share of mobile homeowners. The *Till* decision will have a particularly widespread impact on their future. A mobile home is no less a home. The "presumptive" application of higher contract interest rates will mean fewer confirmed and completed Chapter 13 plans and fewer older Americans who can save those homes.

Contract Rate by Law: Other Examples

In a series of other provisions, Congress explicitly has permitted creditors to collect, in bankruptcy, either a market-based or contract rate of interest. In general, the Code limits a creditor's ability to avoid the automatic stay and proceed against property subject to a security interest. *See* 11 U.S.C. § 362(d). For one kind of creditor, however, secured by "single asset real estate," 11 U.S.C. § 101(51B), Congress has guaranteed a specific rate of interest.[9] To keep the property, the debtor must make monthly interest payments "at a current fair market rate on the value of the creditor's interest in the real estate." 11 U.S.C. § 362(d)(3).

The Bankruptcy Code also preserves the contractual rights of oversecured creditors: "[t]o the extent that an allowed secured claim is secured by property the value of which ... is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and *any reasonable fees, costs, or charges provided for under the agreement under which such claim arose*." 11 U.S.C. § 506(b) (emphasis added); *see also United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989).

[9] Congress created several specific procedures for business bankruptcy cases that involve only one piece of real property—a single apartment building, for example—in response to reported abuses by debtors. *See generally* 11 U.S.C. § 362(d)(3).

In settling the rights of unsecured creditors, as well as secured creditors, Congress has made another deliberate decision to recognize market forces. The reaffirmation provision, section 524(c), enables a debtor to retain property through bankruptcy. In effect, it allows a debtor to "reaffirm" a debt voluntarily, entering into a new agreement with a creditor, even though the debt is dischargeable and the debtor has no obligation, post-bankruptcy, to pay. Section 524 permits a debtor to pay any creditor *any* negotiated rate of interest—typically, in exchange for retaining purchased goods or obtaining new credit. The parties themselves determine the interest rate.

Finally, another fundamental principle of the Bankruptcy Code—the debtor's ability to assume or reject executory contracts—demonstrates that Congress can and does mandate strict adherence to pre-petition contract terms in specific circumstances. Under 11 U.S.C. § 365(b), the debtor can assume a contract or lease but only if the debtor cures "any actual pecuniary loss" from any default in the contract's terms. The debtor must honor all of the contract's terms to benefit from it post-bankruptcy.

In summary, the Code generally permits debtors, whether conglomerates in Chapter 11 or families in Chapter 13, to modify contractual terms in a court-approved plan. The exceptions to that general rule are necessarily explicit. With the sole exception of home mortgage rates, Congress has avoided guaranteeing any creditor the benefit of the contract rate of interest. All that is guaranteed is the collateral's "value, as of the effective date of the plan" for secured creditors receiving installment payments in Chapter 13.

D. By Providing Specific Rates Of Interest In Other Sections Of The Code, Congress Necessarily Excluded Contract Rates From Section 1325.

"Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally

and purposely in the disparate inclusion or exclusion." *Russello*, 464 U.S. at 23 (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972)). Congress expressly provided for a contract or market rate of interest in several Code sections, *e.g.*, 11 U.S.C. §§ 1322(b)(2), 324(d)(3), and provided for contractual fees and costs in another, § 506(b). But Congress provided no such guarantee for cramdowns. Indeed, by definition, a cramdown involves the modification of creditors' rights, whether the loan was for a car, a mobile home, or any other property—except, of course, a home mortgage. *See Am. Gen. Fin., Inc. v. Paschen (In re Paschen)*, 296 F.3d 1203, 1206 (11th Cir.), *cert. denied*, 123 S. Ct. 696 (2002); *Key Bank N.A. v. Milham (In re Milham)*, 141 F.3d 420, 425 (2d Cir. 1998).

This Court has used a similar comparative analysis to interpret other sections of the Bankruptcy Code. In *Timbers*, the issue was "whether undersecured creditors are entitled to compensation ... for the delay caused by the automatic stay in foreclosing on their collateral." 484 U.S. at 369. In response, this Court had to reconcile section 362 with another Code provision, section 506(b): "[t]o the extent that an allowed secured claim is secured by property the value of which ... is greater than the amount of such claim, there shall be allowed ... interest on such claim ...."

The Court held that the undersecured creditor could not collect post-petition interest during the bankruptcy:

> If the Code had meant to give the undersecured creditor, who is thus denied interest on his [entire] *claim*, interest on the value of his *collateral*, surely this is where that disposition would have been set forth, and not obscured within the "adequate protection" provision of § 362(d)(1). Instead ..., § 506(b) would simply have said that the secured creditor is entitled to interest "on his allowed

> claim, or on the value of the property securing his allowed claim, whichever is lesser."

Timbers, 484 U.S. at 372-73. Had Congress intended undersecured creditors to receive interest on the value of their collateral, the statute would have so stated.

The cramdown statute can be evaluated, similarly, only in the context of the entire Bankruptcy Code. *See id.* at 371. The absence of any language requiring a contract or variable rate of interest in section 1325—and the complementary presence of precisely that language for home mortgage lenders in that section and for others elsewhere in the Code—unequivocally reflects legislative intent. Congress did not intend to apply a contract rate of interest in Chapter 13 cramdowns.

II. SECTION 1325 PERMITS SECURED CREDITORS ONLY THE TIME VALUE OF MONEY, EXPRESSED IN THE TREASURY BILL RATE.

Congress understands that a dollar tomorrow is worth less than a dollar today, so it added that factor to the Chapter 13 repayment plan. *See* H.R. REP. NO. 95-595, at 413 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6369 (the identical cramdown provision in Chapter 11 is intended to recognize the "time-value of money"). By choosing "value, as of the effective date of the plan" as the quantitative measure, Congress compensated secured creditors for the delay in receiving the value of the collateral at confirmation, but it offered nothing more.

> Confirmation of any [Chapter 13] plan requires that the plan proponent compensate a secured creditor for any delay in receiving the payment of the value of its collateral. The courts agree that the Code requires a *time-value of money analysis* comparing the interest rate offered with the proposed deferred payments to the creditor at a minimum rate found by the court to fairly and equitably compensate the creditor for the delay.

Hon. John K. Pearson et al., *Ending the Judicial Snipe Hunt: The Search for the Cramdown Interest Rate*, 4 AM. BANKR. INST. L. REV. 35, 36-37 (1996) (emphasis added).

A secured creditor that receives more than the time value of money receives not "value, as of the effective date of the plan" but, instead, compensation for risk, reimbursement of overhead, profits or another premium. Those elements are not included either in the framework for Chapter 13 or in the explicit statutory language of section 1325—except, of course, for home mortgage lenders.

A. The Time Value Of Money, Expressed In The Treasury Bill Rate, Is The Only Measure Consistent With Section 1325's Plain Language.

The contract rate presumptively imposed by the Seventh Circuit, advancing the "coerced loan" theory, has no basis in the Bankruptcy Code, its context or its purpose. What, then, is the statutory basis for determining "value" over time?

Three circuits—the Second, Eighth and the Ninth—have adopted a formula to determine the appropriate rate of interest in cramdowns. *See supra* at 6. This approach generally uses a standard rate objectively determined and, then, adds a risk premium, usually between one and three percent, to arrive at an appropriate cramdown interest rate.

The premium formula is preferable to the coerced loan method because it provides consistent treatment for all secured creditors without a windfall for subprime lenders. Yet it, too, lacks a statutory basis. While the formula is more objective, more predictable and easier to apply than the coerced loan presumption, there is a more objective and predictable standard that expresses the mandate of Congress.

The Treasury bill rate is the most commonly used standard to compensate for the time value of money.[10] *See,*

[10] "Bonds issued by the U.S. Treasury Department have different names depending on their term to maturity. Treasury bills are short-term

e.g., *Standard Mfg. Co., Inc. v. United States*, 42 Fed. Cl. 748, 778 (1999) (most appropriate rate for calculating damages for the delay in receiving past due royalties because it "account[s] for inflation while avoiding a reward for risks which the plaintiff did not undertake"); *MHC, Inc. v. Oregon Dep't of Revenue*, 66 F.3d 1082, 1090 (9th Cir. 1995) (proper way to calculate interest on unpaid taxes because it places "the prevailing party in the same position in which it would have been had it not been deprived of the sum owed it but instead had benefitted from the full use of the money during the period of deprivation.").[11] Establishing the time value of money through the Treasury bill rate is easily ascertainable and predictable. Courts, accountants, parties negotiating contracts and financial markets use the rates for literally millions of transactions daily to determine what a dollar today is expected to be worth any time in the future.

B. Congress Used Precisely The Same Language At Issue Here To Describe The Collective Rights Of Unsecured Creditors In Chapter 13.

The Treasury bill rate maintains equal treatment among secured creditors. Of no less importance, it ensures the consistent treatment of all creditors mandated by Congress.

In describing the amount that the plan must provide secured creditors, section 1325 requires that they retain their lien and that: "the value, as of the effective date of the plan,

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obligations, with maturity of up to 1 year...." JEFFREY D. SACHS AND FELIPE LARRAIN, MACROECONOMICS IN THE GLOBAL ECONOMY 621 (1st ed. 1993).

[11] Congress also directed the use of the Treasury bill rate to calculate the time value of money in all civil and criminal cases. Federal law sets the post-judgment interest rate in civil cases: "Such interest shall be calculated from the date of the entry of the judgment, at a rate equal to the weekly average 1-year constant maturity Treasury yield ... for the calendar week preceding the date of the judgment." 28 U.S.C. § 1961(a); *see* 11 U.S.C. § 726(a)(5). Similarly, interest on unpaid criminal fines or restitution is computed "at a rate equal to the weekly average 1-year constant maturity Treasury yield ...." 18 U.S.C. § 3612(f)(2)(B).

of property to be distributed under the plan on account of such [secured] claim is not less than the allowed amount of such claim." In the immediately preceding section, however, Congress used identical language to describe the required payments to *unsecured* creditors. The plan must ensure that:

> [T]he value, as of the effective date of the plan, of property to be distributed ... on account of each allowed unsecured claim is not less than the amount that would be paid ... if the estate of the debtor were liquidated under chapter 7 ... on such date.

11 U.S.C. § 1325(a)(4). In other words, for unsecured creditors, the plan must provide at least the present value of what they would have received in liquidation.

Both secured and unsecured creditors rely on precisely the same language—"value, as of the effective date of the plan"—to determine the amount to be paid on their claims. In the avalanche of litigation over the amounts payable in Chapter 13, however, no one has ever made the audacious argument that unsecured creditors collectively should receive a premium to reflect the "risk" that the debtor will not be able to repay as promised, a "profit," or the "overhead" that the creditors have borne. No one contends that "value, as of the effective date of the plan" entitles different unsecured creditors to different present value calculations based on the contract rates of interest they once charged or the interest rate they could charge if they lent that money today.

An unsecured subprime credit card lender and a physician (who charges no interest and has no lien) are entitled to the same treatment of their claims, the "value" of what they would have received in liquidation. "Surely, Congress did not intend that each unsecured creditor would receive a market rate or its contract rate of interest ... with different unsecured creditors receiving different rates, depending on the type of loan." 8 COLLIER ON BANKRUPTCY ¶ 1325.06[3][b], at 1325-36 (Alan N. Resnick & Henry J.

Sommer eds., 15th ed. rev. 2003). Unsecured creditors share a uniform basis for determining "value, as of the effective date of the plan"—regardless of their individual contract rates. So should secured creditors.

According to the appellee, "value, as of the effective date of the plan" has two different meanings—one in section 1325(a)(4) and a wholly different meaning a few lines later in the Code in section 1325(a)(5). Congress could have provided a different formulation for the two groups of creditors, but it did not. It is not for the courts to insist on differential repayments among creditors within a single class (secured or unsecured), nor to insist that different classes of creditors be treated differently when the Congressional framework does not call for it.

III. THE SEVENTH CIRCUIT UPSET THE CAREFUL BALANCE AMONG CREDITORS ESTABLISHED BY CONGRESS IN CHAPTER 13.

Chapter 13 creates a defined, finite pool for repayment. To confirm a plan, the Bankruptcy Code requires that *all* debtors pay *all* of their "disposable income" to a trustee for distribution to their creditors. By definition, if one creditor takes more, either the plan will not be confirmed or less will remain for all of the others. Congress deliberately balanced the competing rights of creditors as well as the creditors' collective rights against those of the debtor. A court-imposed contract-based rate of return that varies from secured creditor to secured creditor (and is unavailable to unsecured creditors) would destroy that balance.

A. Chapter 13 Is A Fixed-Payment System.

Both Chapter 11 and Chapter 13 use a debtor's post-petition income to pay pre-petition debt through a plan of reorganization. The principles are the same, whether for a retired couple or for a multinational conglomerate: repayments over time generally yield greater returns for creditors collectively, and a reorganized debtor is a stronger economic competitor.

In both Chapter 11 and Chapter 13, certain creditors are entitled to certain minimum payments (a plan must propose to pay taxes in full, for example, and to pay creditors at least the present value of what they would have received in liquidation). *See* 11 U.S.C. §§ 1129, 1325. In Chapter 11, while an individual creditor always can object, the total a debtor must repay ultimately will be subject to a vote of the creditors. *See* 11 U.S.C. §§ 1102, 1103. Not surprisingly, Chapter 11 debtors negotiate with their creditors to achieve a consensual plan to provide for payments that, all parties agree, are both reasonable and sustainable.

By contrast, Chapter 13 has no negotiate-and-vote structure. Families with more than $1.15 million in secured and unsecured obligations are barred from Chapter 13. So are corporations. *See* 11 U.S.C. § 109(e). To create a workable system for financially-troubled consumers and to assure pro-rata protection even for creditors with small claims, Congress designed Chapter 13 with low transaction costs. Creditors have no right to vote on the reorganization plan, eliminating much of the need for negotiation. Instead, Congress mandates the repayment structure for each class of creditors, and a trustee administers it.

Under the 1978 Code as enacted, Chapter 13 debtors unilaterally set the repayment amount. *See* 11 U.S.C. §§ 1322, 1325 (1978). Once they met certain minimum payments, the debtors needed only to convince a bankruptcy judge that their proposed payments were "in good faith." 11 U.S.C. § 1325(a) (1978). In 1984, however, Congress changed that. It required that Chapter 13 debtors commit *all* of their "disposable income" to their repayment plans. 11 U.S.C. §§ 1322(a)(1), 1325(b). (For the Tills, that is $740.00 a month.)

Now, a debtor can confirm a plan of reorganization only if (among other constraints) the debtor agrees: first, to pay secured creditors the value of their collateral; second, to pay unsecured creditors at least the value they would have

received in liquidation; and, third, to commit all disposable income for three to five years to the repayment plan. *See* 11 U.S.C. § 1325. With this change, the focus in Chapter 13 shifted to the competing rights of creditors.

Any decision that permits one creditor to increase its own payments means that other creditors lose payments. In addition, every increase in the amount any one creditor can demand as a condition of confirmation—the interest rate a mobile home lender receives for cramdown confirmation, for example—will deny some debtors any relief in Chapter 13, often resulting in the loss of the home. Every plan must simultaneously satisfy the amount guaranteed by statute for each class of creditor *and* provide a minimum amount of disposable income for general distribution. Accordingly, as the first amount increases, it inevitably exhausts the disposable income pool in a growing number of cases. When that happens, the debtor cannot confirm a plan. The debtor then must either liquidate under Chapter 7 or flee the bankruptcy system altogether, leaving creditors with little or no repayment or with a free-for-all collection stampede under non-bankruptcy law.

This Court's decision will apply to all secured debt in Chapter 13—car loans, mobile home loans, loans secured by retirement plans, and credit card debts secured by the consumer items purchased. The same "value" language appears in Chapter 11 and Chapter 12 as well as in Chapter 13. As a result, the implications of this case resonate universally in the Bankruptcy Code. The Seventh Circuit's decision endorsing unbalanced interest rates threatens the balance of the entire bankruptcy system.

B. A Contract-Based Present Value Rule Would Frustrate Congress's Well-Established Policies.

Bankruptcy law has long embraced the fundamental premise that, in distribution, "equality is equity." *United States Rubber Co. v. American Oak Leather Co.*, 181 U.S. 434, 452 (1901). Permitting some creditors to demand their

pre-petition contract rate of interest frustrates the universally recognized principle that creditors holding legally similar rights, secured or unsecured, should receive equal treatment within their class. *See Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 543 (1946) (bankruptcy plans must be "fair and equitable" and not "discriminate unfairly" against any creditors).

Each general unsecured creditor receives the same proportional distribution from the estate, regardless of the interest rates "established" in their pre-bankruptcy consumer contracts. This principle is no less compelling for the treatment of interest for secured creditors. Any two secured creditors suffer the same deprivation of their rights in bankruptcy. They are limited by law to the same calculation of their allowed secured claims. *See* 11 U.S.C. § 506(b). They face the same risk from the debtor's failure to make plan payments, and they each feel the potential impact of the lost time value of money. At the same time, all secured creditors enjoy the same protection in the bankruptcy system—court and trustee supervision of the debtor, for example, and trustee administered payments.

A uniform interest rate for the time value of money, on each allowed secured claim, guarantees equality among the secured creditors in addition to protecting debtors. If, however, each secured creditor is entitled to demand—as a matter of law—the interest payment in its original loan, equality disappears.

> These creditor-based approaches to interest rates ... in Chapter 13 cases are nightmares of logic and application. Nothing in § 1325(a)(5)(B)(ii) suggests that "value, as of the effective date of the plan" is a creditor-specific concept. If present value varies from creditor to creditor depending on facts specific to each creditor's financial condition, management and lending practices, then the

> interest rate at confirmation in a Chapter 13 case will be different with respect to every claim .... It is not imaginable that Congress intended "value, as of the effective date of the plan" to mean that inefficient, poorly managed lenders get higher interest rates than well managed, better capitalized lenders.

2 LUNDIN, CHAPTER 13 BANKRUPTCY § 112.1, at 112-9.

Three cases illustrate the principle: a car dealer who sells an average used car (sale price: $13,493) with the average car loan interest rate (5.6 percent), a car dealer who sells the same used car at the Tills' subprime rate (21 percent), and a car dealer who sells the car for zero percent or nominal interest, adding $3,000 to the sales price to compensate for the time value of the money.[12] If the debtor filed for bankruptcy having just purchased all three cars, all three creditors would be entitled to the present value of the replacement cost of the car: $13,493 (under the opinion in *Rash*) regardless of the actual purchase price or the loan amount due. If the cramdown interest rate were uniform, all three would enjoy the same protection in Chapter 13, taking the same risks and receiving the same payments.

Yet if the interest payments depend on each creditor's contract rate, dramatic differences appear. If the debtor financed the car purchase over five years, the subprime lender would receive $365 each month in a reorganization plan. The average-rate lender would be entitled to monthly payments of $258. The zero-interest lender would receive $225. Over the five year life of the plan, those differences would increase exponentially.

[12] National Auto Dealers Ass'n, *Average Dealership Profile, May 2003, at* http://www.nada.org/content/NavigationMenu/MediaCenter/NADAData/20033/May2003.pdf (July 2003); Bankrate.com, *Rates, calculators, indepth articles and professional advice, at* http://bankrate.com/brm/rate/auto_home.asp (accessed on Aug. 11, 2003).

- At zero-interest, the dealer would receive total payments of $13,493 (the car's actual value)
- At the average rate, the dealer would receive $15,480
- At the subprime rate, the dealer would receive $21,900

The careful balance Congress established—treating all secured creditors equally, giving all the same rights to collect the present value of their collateral and denying all of them the right to repossess the collateral and resell it—would evaporate. Instead, the pre-bankruptcy "bargains," not the Bankruptcy Code, would govern the distribution of the debtor's assets. Only the time value of money compensates all of the creditors equally and fairly.

Every dollar paid to a secured creditor is a dollar not paid to an unsecured creditor. In the example above, the $8,400 difference between the payments at "zero interest" and those at the subprime rate would be available to be divided equitably among all of the creditors. The application of the Treasury bill rate would compensate the secured creditor for the delay in receiving the collateral's value but still leave $8,040, over the life of the plan, for unsecured creditors. Apply the subprime rate, however, and all of the difference goes to one creditor. A decision to affirm the Seventh Circuit would literally eliminate millions of dollars annually in recoveries for unsecured creditors. The loss would fall particularly hard on health care providers and other unsecured creditors that have little opportunity to charge any interest and on the older Americans who rely disproportionately on them.

Today, debtors pay an estimated $3 billion to creditors through the Chapter 13 system. Ed Flynn et al., *Bankruptcy by the Numbers—A Tale of Two Chapters: Financial Data*, 21 ABI J. No. 8 (Oct. 2002), *available at*, http://www.usdoj.gov/ust/press/articles/abilo2002.htm. Every debtor denied access to Chapter 13 by the Seventh Circuit's "coerced loan" approach to interest rate calculations is a debtor, typically an

older American, who does not pay his or her health care provider or insurer or loses the family home. Every creditor, other than a subprime lender, loses twice—once in the distributional system for debtors who still can confirm and complete a Chapter 13 plan and once in the harsh consequences, including no payment at all, for debtors who can neither confirm nor complete a plan.

The effect on a debtor of a secured creditor's demand for interest at the contract rate is less obvious, but no less important. To continue the example, for the debtor who has $300 a month in disposable income, the difference between a Treasury bill rate for the time value of money ($230) and a subprime rate ($365) is literally the difference between confirming a plan and saving a home in Chapter 13 and liquidating in Chapter 7. The test for confirmation—that the debtor commit all disposable income *and* that secured creditors receive the value of their allowed secured claims—means that some plans simply cannot be confirmed if a subprime interest rate applies through Chapter 13.

Any denial of access to Chapter 13 falls hardest on homeowners, particularly on older Americans who are more likely to own their own home.[13] While they cannot rewrite their contracts with their mortgage lenders, Chapter 13 offers them a unique opportunity to de-accelerate a mortgage in default and catch up on their payments. Growing up during the Depression, many struggled to purchase and maintain their home. Now, those homes are their principal asset. Without access to Chapter 13, more Americans will find it harder to keep their homes, and more older Americans will face a bleak future.

Congress consistently has reaffirmed the principle that whether the debtor uses Chapter 7 or Chapter 13, "bankruptcy relief should be effective, and should provide the debtor with a fresh start." H.R. REP. NO. 95-595, at 118, 129 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6078-79. Beyond that, Congress has expressed a clear preference for chapter 13 proceedings (the "use of the [consumer] bankruptcy law should be a last resort" and "if it is used, debtors should attempt repayment under Chapter 13...."). *Id.* at 117.

[13] More than 30 million Americans over the age of 55 own their principal residence. *The Policy Book: AARP Public Policies 2003* at 9-1.

The flexibility permitted in Chapter 13 is "central to the implementation of the congressional goal" of encouraging its use. 8 COLLIER ON BANKRUPTCY ¶ 1322.01, at 1322-5. An indispensable component of that flexibility is the ability to bring all secured creditors—those charging 21 percent interest and those charging no interest—into alignment, not to cripple a Chapter 13 plan before it begins by permitting one creditor to demand an extraordinary rate of interest.

C. The Use Of The Treasury Bill Rate, To Measure The Time Value Of Money, Will Ensure That No Creditors Will Be Overcompensated.

This Court already has established the principle that secured creditors in bankruptcy are not permitted to collect for benefits they have not conferred on the debtor:

> Our recognition that the replacement-value standard, not the foreclosure-value standard, governs in cram down cases leaves to bankruptcy courts, as triers of fact, identification of the best way of ascertaining replacement value .... *[R]eplacement value, in this context, should not include certain items. For example, where the proper measure of the replacement value of a vehicle is its retail value, an adjustment to that value may be necessary:* ***A creditor should not receive portions of the retail price, if any, that reflect the value of items the debtor does not receive when he retains his vehicle,*** *items such as warranties, inventory storage, and reconditioning.*

Rash, 520 U.S. at 965 n.6 (emphasis added). Determining the value of collateral retained by the debtor in a Chapter 13 cramdown, this Court emphasized that creditors should not receive any compensation unless the Bankruptcy Code explicitly entitles them to it.

A judicially-imposed "contract rate" in bankruptcy is neither a practical nor a meaningful concept. The "coerced loan" theory's fundamental assumption that cramdown actually forces a new loan upon the unsuspecting subprime creditor overlooks the vital point that ordinary market forces are no longer at work in Chapter 13. These are not new loans at all—coerced or otherwise—just claims in bankruptcy.

The Bankruptcy Code imposes repayment requirements precisely because the each-creditor-for-itself approach of the market has been replaced by the collective action of bankruptcy. The debtor's post-filing earnings, along with all of the debtor's other assets, become property of the estate and their disposition subject to supervision by the court. The law relieves creditors of the burdens associated with making loans, such as hiring legal counsel or collection agents to assert their rights. A court-appointed trustee monitors the debtor for them, ensuring that the debtor has committed all disposable income to repayment under the plan. The trustee supervises payments as well and brings the debtor to court if payments are not timely made.

The trustee has the power to order funds deducted from a debtor's paycheck if he or she fails to make payments, even in states where wage deduction is otherwise unavailable. *See* 11 U.S.C. § 1325(c). If the debtor's income rises, the repayment to creditors also rises under 11 U.S.C. § 1329. The debtor is prohibited from purchasing any goods and services beyond those the court deems reasonably necessary for daily life. Chapter 13 "aggressively direct[s] the finances of the debtor"—all at no cost to the individual creditor. Roger Whelan et al., *Consumer Bankruptcy Reform: Balancing the Equities in Chapter 13*, 2 AM. BANKR. INST. L. REV. 165, 185 (1994).

By contrast, if there were a post-petition "market," as the coerced loan theory presumes, lenders would have to bear all the costs of supervision. They would not benefit from the extraordinary powers granted the court and the trustee in Chapter 13. Accordingly, any contract rate overcompensates creditors for administrative and collection costs that are either reduced or eliminated. "Indeed, in no reported case has a court concluded, based on evidence presented, that any actual market exists in which a lender makes loans to debtors under the circumstances which generally prevail in reorganization." David G. Epstein, *Don't Go and Do Something Rash About Cram Down Interest Rates*, 49 ALA. L. REV. 435, 464 (1998).

Bankruptcy was not designed to guarantee creditors' profits, which differ widely from creditor to creditor based on risk, market conditions and business judgment. In rejecting the coerced loan approach later used in the Seventh Circuit, the Second Circuit emphasized just that:

> The objective of § 1325(a)(5)(B)(ii) is to put the creditor in the same economic position that it would have been in had it received the value of its allowed claim immediately.... There is no reason, therefore, that the interest rate should account for profit.... Otherwise, the creditor will receive more than the present value of its allowed claim.

In re Valenti, 105 F.3d at 63-64. The determination of value, as of the effective date of the plan, "should not be controlled by a rate negotiated pre-petition between the parties. Such pre-petition rates include the lender's profits and costs[,] but all that is required under section 1325(a)(5)(B) is that [the secured creditor] receive the present value of its claim adjusted for inflation and delay in payment." *In re Marquez*, 270 B.R. 761, 770 (Bankr. D. Ariz. 2001). To ensure that the

secured creditor receives that value, this Court should apply the Treasury bill rate—nothing more, nothing less.

CONCLUSION

The economic vulnerability of older Americans will grow even more severe as the next generation reaches retirement age. *See* TERESA A. SULLIVAN, ELIZABETH WARREN AND JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 38-41, 164-66 (2000). They are entitled to the protection Congress gave them in the Bankruptcy Code. Creditors have the Code's protection as well. The statutory balance established by Congress, however, does not entitle subprime lenders to demand greater returns at the expense of every other creditor.

Congress designed Chapter 13 to ensure that families have both a fresh start and the opportunity to repay at least some of their debts, retaining at least some of their property including the family's home. AARP joins the Tills in asking this Court to reverse the decision of the U.S. Court of Appeals for the Seventh Circuit. Some creditors should not be permitted to charge a "contract" rate of interest that will both overcompensate them and undermine the effectiveness and balance of the bankruptcy system itself.

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LEE M. TILL AND AMY M. TILL,

Petitioners,

v.

SCS CREDIT CORPORATION,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF AMICUS CURIAE FOR COMMERCIAL LENDERS IN SUPPORT OF RESPONDENT

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Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees & Exclusivity*, 6 BANKR. DEV. J. 1 (1989) 12

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Todd J. Zywicki, *Cramdown and the Code: Calculating Cramdown Interest Rates Under the Bankruptcy Code*, 19 THURGOOD MARSHALL L. REV. 241 (1994) 19, 20, 21, 22, 23

INTEREST OF THE AMICI CURIAE[1]

Amici curiae are institutions (together, "Commercial Lenders") that collectively loan billions of dollars annually to commercial entities. Amici are:

Allstate Life Insurance Company
Bank of America
Bank of Montreal
The Bank of New York
Barclays Bank PLC
Bear, Stearns & Company
Deutsche Bank Trust Company Americas
Fernwood Associates, LP
General Electric Capital Corporation
Highland Capital Management LP
Lampe, Conway & Co. LLC
Morgan Stanley Prime Income Trust
PPM America
Tennenbaum Capital Partners
Van Kampen Investment Advisory Corporation

The Commercial Lenders typically secure these loans with collateral. It is common for companies to use their assets to secure millions of dollars in financing. For example, companies may obtain the funds needed for day-to-day operations by taking out a loan on a hotel, office building, or other piece of commercial real estate. Other businesses use their plants, equipment, or accounts receivable as collateral. In any of these instances, commercial lenders become secured creditors in the event of bankruptcy.

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[1] Pursuant to Rule 37.3 of the Rules of this Court, the parties have consented to the filing of this brief. The parties' letters of consent have been lodged with the Clerk. This brief was not authored, in whole or in part, by counsel for any party, and no person or entity other than the amici curiae and their counsel made any monetary contribution to the preparation or submission of the brief.

The parties to this brief participate routinely as secured creditors in Chapter 11 reorganizations. Large Chapter 11 cases frequently involve creditors' claims totaling tens of millions or hundreds of millions of dollars. In 2002 alone, Chapter 11 bankruptcies were filed by 114 public companies each having assets of more than $100 million. THE 2003 BANKRUPTCY YEARBOOK & ALMANAC 44-47 (Christopher M. McHugh ed., 2003).

This case requires the Court to interpret language in Chapter 13 of the Bankruptcy Code, but substantially equivalent language applies to secured creditors in Chapter 11 cramdowns (cases in which a plan of reorganization is confirmed over the objections of secured creditors). See *infra* p. 4. Petitioners urge the Court to apply the Code's language atextually and in a manner that does not provide lenders with the present value of their secured claims. Ensuring that secured creditors receive the protections to which they are entitled under the Code is critical to the Commercial Lenders' business operations.

SUMMARY OF ARGUMENT

Where a debtor seeks to confirm a plan of reorganization that has not been accepted by a secured creditor, the Bankruptcy Code requires that the secured creditor receive under the plan future payments from the debtor that equal, in present value terms, the market value of the collateral securing the creditor's claim. The Court is now asked to decide what it means to say that a series of promised, future payments has a particular value as of the plan's effective date. The answer to this question necessarily determines the interest rate the debtor must pay on the secured creditor's allowed secured claim in order to ensure that the payments provided for under the plan permit the secured creditor to receive the required value as of the plan's effective date. Consistent with the Court's decision in *Associates Commercial Corp.* v. *Rash*, 520 U.S. 953 (1997),

the market provides a clear answer to this question. A creditor's right to future payments from the debtor is currently worth whatever price that right would command on the open market. The creditor's right to future payments under a "cramdown" plan thus has a present value equal to the market value of its collateral—as the Code requires—only if the reorganization plan requires the debtor to make the payments at the interest rate it would have to pay on a loan obtained for the same amount on the open market on the plan's effective date.

In the commercial lending market, with which the Commercial Lenders are intimately familiar, determining the market rate of interest on a loan to any particular borrower is a straightforward exercise. Lenders in competitive financial markets consider putative borrowers' individual risk profiles and set commensurate interest rates every day. In the context of a cramdown plan of reorganization in Chapter 11 where, by definition, parties do not agree on an interest rate, lenders can—and regularly do—submit evidence concerning what rate the market would offer a borrower with the profile of the debtor as reorganized under its proposed bankruptcy plan.

Rather than even attempt to approximate a market rate of interest, however, petitioners propose to set the interest rate under nonconsensual plans of reorganization based on a "formula" that they admit would do little more than compensate creditors for the time value of money and that therefore fails to afford the secured creditor value equal to the market value of its collateral. This formula is not only inconsistent with *Rash* and without any basis in the Bankruptcy Code, it arises from a series of erroneous presumptions. Petitioners wrongly assume, for example, that their calculus does not need to account for the debtor's individual risk profile because all or nearly all risk of non-payment disappears in bankruptcy. Petitioners also proceed from the erroneous presumption that lenders in a competitive market enjoy economic profits that must be eliminated in arriving at present value for cramdown purposes. Based on

these and other threshold errors, petitioners define "value" in a wholly artificial manner that systematically undercompensates secured creditors by ignoring statutory text, this Court's jurisprudence, and market reality.

ARGUMENT

I. The Bankruptcy Code Entitles A Secured Creditor To A Schedule Of Future Payments That The Creditor Could Market Today For The Value Of Its Collateral.

One of three things must be true of each secured claim in bankruptcy before the court can confirm a Chapter 13 plan: either "the holder of such claim has accepted the plan"; "the debtor [has] surrender[ed] the property securing such claim to such holder"; or the secured creditor has retained its lien on the collateral "securing such claim" and "*the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim.*" 11 U.S.C. § 1325(a)(5) (emphasis added). It is this last, italicized requirement—"designed to protect Chapter 13 creditors," *Johnson* v. *Home State Bank*, 501 U.S. 78, 87 (1991)—that the Court is asked to interpret here. Chapter 11 contains essentially the same provision; it requires that a secured creditor "receive * * * *deferred cash payments totaling at least the allowed amount of such claim, of a value,* as of the effective date of the plan, *of at least the value of such holder's interest* in the estate's interest in such property." 11 U.S.C. § 1129(b)(2)(A)(i)(II) (emphasis added).

Before the italicized language comes into play, however, a bankruptcy court must determine the "allowed amount" of a secured claim—which this Court has held must be determined based on the market value of the underlying collateral when the debtor proposes to retain possession and control of the collateral. See *Associates Commercial Corp.* v. *Rash*, 520 U.S. 953, 960-965 (1997); *infra* pp. 8-9. If the debtor is going to retain possession of the collateral, §§ 1129(b)(2) and 1325(a)(5)

thus ensure that whatever "property" the creditor is scheduled to receive "under the plan" has a value "not less than" the collateral's current market price.[2] There is near universal agreement—and the parties to this case do not dispute—that this provision guarantees the secured creditor "property" under the plan with a "present value" of no less than the market value of its collateral. See *Rash*, 520 U.S. at 957; see also *Rake* v. *Wade*, 508 U.S. 464, 469 (1993) ("§ 1325(a)(5)(B)(ii) guarantees that property distributed under a plan on account of a claim, including deferred cash payments in satisfaction of the claim * * * must equal the present dollar value of such claim as of the confirmation date"). The "property" a creditor usually receives under a bankruptcy plan is the debtor's promise to make specified payments over time. At issue here is the interest rate the debtor must pay on an allowed secured claim so that this promise of future payments has a "value" to the secured creditor on the plan's effective date equal to the collateral's market value on that date.

The financial markets allow us to know with reasonable certainty what a promise of future payments is worth today. "[T]he value, as of the effective date of the plan, of property [*i.e.*, the right to payments] to be distributed under the plan," 11 U.S.C. § 1325(a)(5), is necessarily the price that the property would fetch on the open market as of the plan's effective date. See *Rash*, 520 U.S. at 960 (the "value of the property" is "the price a willing buyer * * * would pay to obtain like property

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[2] The secured creditor is not entitled to the full present value of the collateral if the creditor is oversecured—*i.e.*, if the collateral is worth more than the creditor's secured claim. In that case, the creditor only has a legal interest in a share of the collateral's value, and the creditor is entitled to property under the plan with a present value no less than the market price of that share. See 11 U.S.C. §§ 506(a), 1129(b)(2)(A)(i)(II). But where, as in this case, a secured creditor in bankruptcy is undersecured, it is entitled to future payments under the plan equal to the present value of the collateral as a whole.

from a willing seller"). Accordingly, the debtor's plan must require the debtor to pay the full amount of the creditor's allowed secured claim plus interest at a rate sufficient to allow the creditor to sell its right to the future payments, on the effective date, for a lump sum equal to the amount of its allowed secured claim. See *In re Bloomingdale Partners*, 155 B.R. 961, 977 n.13 (Bankr. N.D. Ill. 1993) ("if the interest rate proposed were adequate, [the creditor] would be able to sell its claim [to future payments] for at least [the present value of its collateral]"); Richard A. Brealey & Stewart C. Myers, PRINCIPLES OF CORPORATE FINANCE 12 (5th ed. 1996) ("the present value of [a] property is also its market price"); see also 7 COLLIER ON BANKRUPTCY ¶ 1129.06[1][b], at 145 (15th ed. rev. 2003) (providing numerical example). The government, in fact, acknowledges that "the value of plan payments depends on their estimated worth in financial markets," and that there should be "a direct, fair market appraisal of the risk-adjusted present value of future payments." U.S. Br. 8. 9. Thus, if a payment schedule provides a creditor holding an allowed secured claim of $1,000 with future payments having a present value of $1,000, the creditor will be able to find a buyer willing to pay $1,000 for the rights to those payments.[3]

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[3] There is a well-developed "secondary market for trading loans." Joseph A. Franco, *The Investment Company Act's Definition of "Security" and the Myth of Equivalence*, 7 STAN. J.L. BUS. & FIN. 1, 18 n.49 (2001); see also Steven Miller, *The Development of the Leveraged Loan Asset Class* in BANK LOANS: SECONDARY MARKET AND PORTFOLIO MANAGEMENT 1, 3, 7 (Frank J. Fabozzi ed., 1998). Indeed, "[s]everal trade organizations and service entities exist dedicated to" this market. Franco, *supra*, 7 STAN. J.L. BUS. & FIN. at 18 n.49. Likewise, "[t]rading in claims of bankrupt concerns" is a "multi-billion dollar market." Michael H. Whitaker, Note, *Regulating Claims Trading in Chapter 11 Bankruptcies: A Proposal for Mandatory Disclosure*, 3 CORNELL J.L. & PUB. POL'Y 303, 303 (1994).

The only interest rate that would allow for such an exchange is the market rate of interest the debtor would have to pay to obtain a new loan in the amount of the allowed secured claim, payable over the period provided for in the plan. To continue the above example, lenders in the market would give the debtor $1,000 today in exchange for a security interest in collateral worth $1,000 and a promise to repay the loan at a market-set rate of interest. Lenders in the market would likewise be willing to pay a *creditor* (instead of the debtor) $1,000 in exchange for the same lien and the same promise from the debtor to repay the $1,000 at the same market-set rate. But if the interest rate is set at below-market rates for a loan to the debtor, the stream of promised payments could not be sold for $1,000—a willing buyer would pay less than that—and thus the "value" of the promised payments will be less than "the allowed amount" of the secured creditor's claim, in contravention of §§ 1129(b)(2) and 1325(a)(5).

This is not to say that the market rate of interest on a new loan to the debtor is the proper interest rate in cramdown because it reflects the secured creditor's "opportunity cost"—*i.e.*, the amount the creditor could make if it received the $1,000 today and lent it to another borrower. Indeed, if the creditor were free to find another borrower, it may well be able to loan the money at a higher interest rate. Rather, a market interest rate that is tied to the reorganized debtor's particular circumstances reflects the reality that each loan has its own risk profile and, accordingly, its own required market rate of interest. The rate at which *the debtor could borrow* an amount equal to the allowed secured claim is dictated by the market, and payment of this rate is required in order to provide the secured creditor with property of a value, as of the plan's effective date, equal to the allowed amount of its secured claim—as §§ 1129 and 1325 provide.

II. Using The Market Rate Of Interest Is Consistent With *Rash*.

As noted above, 11 U.S.C. §§ 1129(b)(2) and 1325(a)(5) entitle secured creditors in a cramdown plan to the present value of the "allowed amount" of their secured claim in bankruptcy. This "allowed" amount, in turn, is determined based upon "the *value* of [the] creditor's interest in the estate's interest in such property." 11 U.S.C. § 506(a) (emphasis added). The question before this Court in *Rash* was the proper measure of the "value" of the creditor's interest in collateral. The Chapter 13 debtors in that case had purchased a tractor truck before filing for bankruptcy. The debtors had purchased the truck on credit, and at the time of their bankruptcy petition they still owed $41,171 to Associates Commercial Corporation ("ACC"), which had been assigned both the loan and the seller's lien on the vehicle. 520 U.S. at 956.

The debtors argued that § 506(a) limited ACC's secured claim to the truck's foreclosure value—the $31,875 net amount that the debtors' expert said ACC would likely receive if it foreclosed on the truck and sold it at auction. *Rash*, 520 U.S. at 957. ACC argued that its allowed secured claim was equal to the vehicle's replacement value—the $41,000 that ACC's expert said it would cost the debtor to purchase such a truck on the market today. *Ibid.* The Court sided with ACC, holding that when the debtor retains its ownership interest in property "the value of the property * * * is the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller." 520 U.S. at 960. In other words, the allowed amount of a secured claim is determined based on the collateral's current, "fair-market value." *Id.* at 959 n.2.

The Court in *Rash* thus analyzed "value" in § 506(a) in terms of the collateral's "fair market" price—the price of exchange between a "willing buyer" and a "willing seller." "Value" should have the same meaning in §§ 1129(b)(2) and

1325(a)(5). The current "value" of promised, future payments is the price at which a willing buyer would purchase the rights to those future payments today. Providing a secured creditor with any less than a right to future payments marketable for the fair price of its collateral would deny the creditor the "value" it is entitled to receive under *Rash*.

This reading of "value" in § 1325(a)(5) is not only consistent with the definition the Court assigned the same term elsewhere in the Code; it is the only reading consistent with *Rash*. In practice, an item's "fair market value" always depends, at least in part, on the financing terms accompanying that price. A "willing buyer" will pay more for an item if the interest rate is favorable. The most recent example of this economic truism is the fact that low interest rates have allowed home sellers to obtain higher sales prices for homes.[4] The two features of the sale—price and payment terms—are inseparable, something even petitioners acknowledge. See Pet. Br. 46-47. Having decided that "value" in § 506 is the collateral's market price, it follows that the proper discount rate to use in §§ 1129 and 1325 is the market interest rate that accompanies that price.

III. Finding The Fair Market Rate Is Typically Straightforward.

A. Chapter 11

The government implicitly agrees that the proper benchmark for the cramdown discount rate is the market rate available for a new loan to the debtor. U.S. Br. 16 n.7. The

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[4] See, *e.g.*, Evan Perez, *Lennar Net Soars as Low Rates Lift Housing Industry*, WALL ST. J., June 11, 2003, at A6 (explaining that "low interest rates" enabled home builder "to sell more homes at higher prices"); Ed Crooks, *Bank's Chief Economist Casts Doubt on Rate Rise*, FIN. TIMES, Oct. 2, 2003, at 2 (listing "low interest rates" among "reasons for the long-term level of house prices to be higher").

government contends, however, that, "unlike the market for automobiles that provided the basis for the replacement-value calculation in *Rash*[,] there is no directly analogous 'market' for discount rates that reflects the unique mix of" factors "that exist in bankruptcy." *Ibid.* That is certainly not correct in the Chapter 11 context: developed national and international commercial financing markets make it relatively easy to determine the rate on a new loan to a borrower with the reorganized debtor's risk profile.

As a general proposition, market rates of interest are determined based on the risk associated with a particular loan. The greater the collateral value relative to the loan amount—*i.e.*, the more the collateral cushion—the lower the interest rate because the creditor's risk of nonpayment is protected to a greater degree against risks both in the borrower's economic fortunes and in the downward fluctuation of the collateral. In the commercial context, where the value of the collateral is equal to the amount of the secured loan, financial markets have longstanding methods for calculating rates. The market generally provides financing in tiers of debt and equity, with the more senior (*i.e.*, less risky) tiers bearing lower rates. This is known as the "investment band" approach. Thus, for example, a borrower seeking to obtain financing in an amount equal to 100% of the market value of the property it owned might receive a loan for an amount equal to 80% of its property on a secured basis. This loan would be oversecured by the collateral as a whole and would accordingly be available at a lower interest rate. The remaining 20% of the financing might then be a combination of junior debt—either unsecured or secured by a junior lien and, therefore, far riskier and at a much higher rate of interest—and an equity interest in the borrower. See, *e.g.*, *In re Deluca*, 1996 WL 910908, at *14-15 (Bankr. E.D. Va. Apr. 12, 1996) (relying on investment band analysis); *In re Cellular Info. Sys., Inc.*, 171 B.R. 926, 943-944 (Bankr. S.D.N.Y. 1994) (same); David G. Epstein, *Don't Go and Do Something* Rash *About Cram Down Interest Rates*, 49 ALA. L.

REV. 435, 464 (1998) (describing use of "investment band" method "to hypothesize the loans that the debtor could obtain in the market place").

The specific rates the market sets for these layers, or "bands" of financing, depends heavily on the borrower's individual risk profile. Banks and other commercial lenders consider an array of borrower characteristics in deciding whether to loan and what interest rate to charge. Lenders generally examine the borrower's credit record, financial statements, stock performance, marketing materials, average bank balance, and the quality of its management team in the hopes of estimating the company's projected growth, the strength of its competition, and the future of the industry as a whole. Steven N. Bulloch, *Shareholder Agreements in Closely Held Corporations: Is Sterilization an Issue?*, 59 TEMP. L.Q. 61, 77 n.120 (1986) (compiling sources and summarizing "factors with which creditors are concerned in making lending decisions"); Brealey & Myers, *supra*, at 852-853 (listing factors to consider in deciding whether customer is a likely credit risk); see also *In re Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990) (listing some of the "host of * * * factors" that lenders consider in setting an interest rate). Lenders may rely in part on leverage, liquidity, profitability, and market value ratios as tools in this process. Brealey & Myers, *supra*, at 766, 853. Each industry, and each business within that industry, has unique characteristics making it more or less risky. Professional lenders assess those characteristics and set a rate commensurate with the particular borrower's overall risk of non-payment.

In Chapter 11 cases, all of this information can be—and is—the subject of evidence, sometimes in the form of expert testimony, offered by the parties. Having considered evidence about the rates available to the reorganized debtor for different tiers of financing, a court would merely need to calculate the weighted average of the various market rates to set an overall discount rate that, as applied to the payment stream contem-

plated by the plan, would provide the secured creditor with property having a value as of the effective date equal to its allowed secured claim. See, *e.g.*, *Deluca*, 1996 WL 910908, at *15 (performing weighted average to calculate "blended rate"); *Cellular Info. Sys.*, 171 B.R. at 944 (rejecting debtor's proposed plan because its cramdown interest rate was below weighted average of rates applicable to investment bands available in the market).

B. Chapter 13

Analogous evidence concerning the debtor's specific risk profile could be offered in Chapter 13 cases where the parties do not agree on an interest rate. (Because an individual's finances are much simpler than a business's, the evidence would not need to be as elaborate as that offered in a business reorganization case under Chapter 11.) The court could then determine a market rate of interest for a loan to the debtor that, as applied to the secured creditor, would afford the secured creditor the present value required by the Code. Petitioners suggest that the market for "subprime" consumer loans is not competitive and cannot serve as the basis for fair discount rates in bankruptcy. Pet. Br. 16 n.14, 17. But there is no reason to think that this segment of the American economy is immune from competition. In any event, nothing prevents the debtor from arguing to the bankruptcy court that suggested market rates are overstated in a particular case based on the debtor's credit/risk profile as the debtor is reorganized under its bankruptcy plan.

Petitioners warn that requiring bankruptcy courts to consider case-specific information to set cramdown rates would burden the courts with evidentiary hearings. See Pet. Br. 9 n.7, 23. But parties usually agree on the discount rate to apply to secured creditors under a bankruptcy plan. See, *e.g.*, Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1, 8 n.17 (1989). Typically, there is no need for the court to hear evidence and set a rate. Moreover, where the parties cannot agree, bankruptcy courts are already required to hold hearings concerning the collateral's market value to determine the amount of the creditor's allowed secured claim. See *Rash*, 520 U.S. at 965 n.6 ("leav[ing] to bankruptcy courts, as triers of fact, identification of the best way of ascertaining replacement value on the basis of the evidence presented"). Indeed, gauging the market interest rate for a borrower with the debtor's risk profile is likely to be much easier and less time consuming than formulating a risk premium out of whole cloth, as petitioners propose, which would also require evidentiary hearings. See, *e.g.*, *Hardzog*, 901 F.2d at 860 ("Courts are not well situated to craft and determine interest rates" but "are well equipped to determine market rates").

C. The Contract Rate

Petitioners and their *amici* spend much of their time challenging the Seventh Circuit's presumption that the parties' contract rate of interest is the appropriate rate in cramdown. The Commercial Lenders agree that the statute does not require any such formal presumption. Market rates may have shifted dramatically, or the debtor's risk profile may have changed, since the parties entered into their contract.

But while the contract rate should not be determinative, it is relevant. The contract reflects an interest rate to which a willing borrower and a willing lender agreed on the open market. It reflects the market's take on the borrower's specific risk profile at a point in time. Things may have changed since the parties negotiated their contract—and these changes are the proper subject of proceedings before the bankruptcy court—but the contract rate is potentially an important piece of evidence. We thus agree fully with the district court in this case, which in deciding for the respondent set an interest rate based on "what the market [would] bear." Pet. App. 36a. The debtor's post-

bankruptcy credit/risk profile warranted application of the rate dictated by the sub-prime market, and the court cited "unrebutted evidence * * * that a sub-prime market exists and that its rate is 21%." *Id.* at 38a. "The fact that the contract rate is 21% [was] not controlling [on the] Court's decision. * * * [W]hat [was] controlling is the market rate." *Ibid.* The district court properly set the discount rate at 21% not because it was the contract rate, but because it was the current market rate for a borrower with the debtor's risk profile. To allow a lower rate in such circumstances would necessarily result in the secured creditor receiving less than the Code requires—property with a value equal to the amount of the allowed secured claim on the plan's effective date.

IV. Petitioners' Proposed "Prime-Plus" Rate Has No Basis In The Statute And Systematically Undercompensates Secured Creditors.

Petitioners urge the Court to adopt a "prime-plus" or "formula" approach to the discount rate. They espouse a rule in which courts begin (and often end) with a riskless rate of interest and, if necessary, add a modest risk premium, usually less than 1% and never to exceed 3%. Pet. Br. 45-49.

One fundamental problem with this method is that it has utterly no textual basis in the statute. A range of 10%-30%, or 100%-300%, would have the same grounding in the text of the Bankruptcy Code: none.

Another basic problem with petitioners' "formula" approach is that it makes no effort at all to predict what the market would actually do, although a focus on the market is inherent in any determination of the "value" of property. On the contrary, petitioners propose a "'present value' analysis" that does little more than compensate "'for the changing value of a

dollar.'" Pet. Br. 21.[5] Petitioners contend that the prime rate will often be the proper discount rate in bankruptcy and that—if creditors receive any compensation for risk above what the prime rate affords—it should be no more than 1% to 3%. *Id.* at 46. In addition to having no basis in the language of the Code, such a crabbed reading of "value" is patently inconsistent with this Court's reliance on market value in *Rash*. Indeed, petitioners recommend their "formula" only by presuming away nearly every element of the free market interest rate.

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[5] Petitioners thus invoke this Court's decisions in *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134 (1974), and *Jones & Laughlin Steel Corp.* v. *Pfeifer*, 462 U.S. 523 (1983), where the "Court has previously examined discounting to present value in other contexts." Pet. Br. 26-27. Petitioners cite these cases for the "limited function of the present value concept" that they describe—a concept meant merely to adjust for "the prevailing market rate for money" and for the "rate of interest [obtainable] on the best and safest investments" using "present value tables standard in the financial community." *Id.* at 27 (emphasis omitted). But these decisions are inapposite. *National Alfalfa* involved "debt discounting"—where debentures are sold below their face amount and the difference in price is treated like interest on debt for income tax purposes. 417 U.S. at 147-155. The case had nothing to do with "discounting" future income streams based on the risk of nonpayment. *Jones & Laughlin Steel* required the Court to determine the proper amount of a one-time award meant to compensate the plaintiff for lost future wages. The Court reduced the award because the plaintiff had a "duty to mitigate" his damages by investing the award at the "best and safest" investment rate. 462 U.S. at 537-538 & n.20. Once again, the case had nothing to do with discounting future income based on the risk of nonpayment.

A. Petitioners Start From The Demonstrably False Premise That There Is No Risk Of Nonpayment In Bankruptcy.

First, and most remarkably, petitioners make the conclusory assertion that the cramdown rate should ignore *all debtor-specific risk data*. "Petitioners contend that, in order to restore a level of uniformity appropriate to a national system of bankruptcy laws, courts must return to the historic concept of discounting to present value, which does not rely upon fact-specific characteristics of the creditor or debtor." Pet. Br. 42; see also *id.* at 9. Petitioners press for a "payment stream discounted to reflect the present value of the 'allowed secured claim' in a fixed amount, without any additional creditor-debtor fact-based considerations." *Id.* at 18. They thus rely heavily on the Sixth Circuit's decision in *In re Kidd*, 315 F.3d 671 (6th Cir. 2003), particularly language in that opinion equating the Chapter 13 cramdown rate with "'the current conventional market rate used for similar loans in the region'"—which "'does not entail an analysis of any particular debtor's credit rating but rather involves a more objective determination of the value of money over time.'" Pet. Br. 39 (emphasis omitted). Petitioners' position, and the language from *Kidd* on which petitioners rely, flies in the face of the plain language of the Code, this Court's jurisprudence, and common sense.

As the government recognizes, a rule that ignores debtor-specific risk factors would be a nonsensical legal fiction.[6] The

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[6] The government recognizes the "virtues" of an approach that accounts for "the case-specific risk of nonpayment"—an assessment "that the bankruptcy court is uniquely competent to make." U.S. Br. 12. The government accordingly advocates a rate that reflects "the risk-adjusted market value of capital." *Id.* at 24. The government correctly concludes that inclusion of such a "case-specific risk" factor in the cramdown rate is consistent with *Rash*, which "adopt[ed] the replacement value as the measure of the collateral" in part because

lending market relies heavily on factors specific to the borrower and its industry in setting an interest rate. See *supra* p. 11. If the idea is to account for the real risks faced by the creditor, as it must be given the statutory requirements for cramdown in both Chapters 13 and 11, then the court must be free to consider any and all facts bearing on that risk. See 7 COLLIER ¶ 1129.06[1][c][iii], at 151 (courts should "assess the riskiness of the loan in relation both to the market for similar loans and the debtor's particular risk profile"). Ultimately, it is because petitioners never recognize that a discount rate "formula" is only as good as its capacity to mimic a competitive market that they do not see the utter arbitrariness of divorcing their formula from the debtor-specific risk factors on which the market most heavily relies.

At times, petitioners reluctantly acknowledge the need for a risk premium in certain cases but seek an arbitrary limit on that premium of between 1%-3%. Foreordaining a risk range is as arbitrary as the practice—squarely rejected by this Court in *Rash*—of splitting the difference between foreclosure and replacement values in appraising collateral. See 520 U.S. at 964 ("Whatever the attractiveness of a standard that picks the midpoint between foreclosure and replacement values, there is no warrant for it in the Code"). The 1% to 3% range comes from *In re Valenti*, 105 F.3d 55 (2d Cir. 1997). Pet. Br. 46. But the *Valenti* court created that range for no reason other than the fact that its "review of the caselaw * * * suggests that the risk premium has been set by bankruptcy courts at from one to three percent." 105 F.3d at 64 (citing three cases). There was no effort in *Valenti* to approximate the rate that a free and competi-

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"'[a]djustments in the interest rate' may not be enough to account for case-specific risks of nonpayment and depreciation of collateral." *Id.* at 12 n.5. In the end, however, the government deviates from a market-based approach to endorse a "prime-plus" formula that would simply "reflect the time value of money." *Id.* at 7-8.

tive market would offer the debtor if it wished to borrow the value of its collateral today.[7]

Underlying petitioners' effort to eliminate (or arbitrarily cabin) the courts' ability to account for the risk of nonpayment is the misguided belief that many "nonbankruptcy market-risk factors are * * * eliminated under Chapter 13." Pet. Br. 45. Petitioners specifically cite the fact that the bankruptcy court must conclude that the plan is feasible, that the debtor must make numerous disclosures, and that the creditor has the right to seek "adequate protection under 11 U.S.C. § 361" and "payment by wage assignment orders." *Id.* at 45-46. Petitioners also note that the debtor will restructure its unsecured debt and that a creditor can "seek dismissal of the case in the event of a material default." *Id.* at 46.

As this Court recognized in *Rash*, however, the "'vast majority of reorganizations fail.'" 520 U.S. at 963; see also Brief for U.S. as *Amicus Curiae* Supporting Petitioner 26, *Associates Commercial Corp.* v. *Rash*, No. 96-454 ("the majority of Chapter 13 plans fail"). The "feasibility" determination is not a demanding one,[8] and in any case is no more than a "prediction[] of future events that might not come true." *In re*

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[7] Even the government concedes that "the risk factor element under a prime-plus approach may need to be larger than some courts have suggested." U.S. Br. 16 n.7.

[8] See, *e.g.*, *In re Weiss*, 251 B.R. 453, 467 (Bankr. E.D. Pa. 2000) ("the feasibility requirement is generally not rigorous"); see also *Kane* v. *Johns-Manville Corp.*, 843 F.2d 636, 649 (2d Cir. 1988) ("the feasibility standard [asks] whether the plan offers a reasonable assurance of success. Success need not be guaranteed"). One study showed that even among cases in which feasibility was challenged and the court expressly found that the plan was feasible, "half of the confirmed, nonliquidating plans did not fully consummate." Nancy R. Baldiga, *Is This Plan Feasible? An Empirical Legal Analysis of Plan Feasibility*, 101 COM. L.J. 115, 130 (1996).

Cassell, 119 B.R. 89, 92 (W.D. Va. 1990). As for the creditor's right to adequate protection, this right only exists before the plan is confirmed. And it "is not always vindicated" even then. *Ibid.*; see *id.* at 92-93 ("Enforcing the right often requires the creditor to expend substantial time and funds in vigilantly monitoring the claim and the collateral so that it may take timely action to protect itself. There is no guarantee that the creditor will receive adequate protection even if it seeks such protection in a timely manner and the bankruptcy court takes timely action").

This Court properly recognized in *Rash* that secured creditors in bankruptcy are actually "exposed to double risks: The debtor may again default and the property may deteriorate from extended use." *Id.* at 962; see *id.* at 963 (because most reorganizations fail, creditors are left "'with only a fraction of the compensation due them'"). Indeed, even if certain circumstances do decrease the risk, "[o]ther factors will tend to increase" it. Todd J. Zywicki, *Cramdown and the Code: Calculating Cramdown Interest Rates Under the Bankruptcy Code*, 19 THURGOOD MARSHALL L. REV. 241, 260 (1994). "For instance, the collateral for the original loan probably provided an equity cushion to protect against depreciation. Because the loan to value ratio for a cramdown loan is one to one, there is no equity cushion." *Ibid.*; see also *Cassell*, 119 B.R. at 92 ("since the loan is for 100 percent of the collateral's value, one might say the bank's risk is greater than before"); *General Motors Acceptance Corp.* v. *Jones*, 999 F.2d 63, 68 (3d Cir. 1993) (observing that "loans coerced in cramdown proceedings are frequently loans without an 'equity cushion'").[9]

In any event, the answer to the parties' dispute over the general risk to creditors in bankruptcy is not to ignore debtor-

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[9] As described above (at pp. 10-11), "investment band" financing provides a market rate even for loans where the loan-to-value ratio is one-to-one.

specific risk factors and arbitrarily prescribe some narrow interest range that is not grounded in the text of the Bankruptcy Code and diverges from market realities, as petitioners propose. Rather, the bankruptcy court should consider debtor-specific facts and set a rate that accounts for whatever risk exists in a particular case—just as the market would—and thereby give the secured creditor future payments with a present value equal to the creditor's claim, as the Code requires.

B. Petitioners Erroneously Presume That Lenders In A Competitive Market Enjoy Economic Profits.

The second basis for petitioners' arbitrary and under-compensatory discount rate formula is the misperception that market interest rates include inappropriate "profits" that bankruptcy creditors should not enjoy. In fact, the market for corporate and other commercial financing is a model of competition. "Financial intermediation is today highly competitive. Money is fungible and flows across the globe; local lenders package and sell their loans on national and international markets in order to attract fresh capital." *Koopmans* v. *Farm Credit Services*, 102 F.3d 874, 876 (7th Cir. 1996). As a result, "profits," as petitioners use the term, do not exist. *Ibid.* (in a competitive market, "[w]hat appears on the books as accounting profit is just the opportunity cost of keeping the firm's assets in this business rather than the next-best alternative"); see also *Cassell*, 119 B.R. at 92 ("the profit component of the market rate is properly considered part of the cost of capital").

The accounting "profits" that appear on the balance sheet of lenders in a competitive market are "indistinguishable from the normal return on capital without which loans will not be made." Zywicki, *supra*, 19 THURGOOD MARSHALL L. REV. at 261. It is "the real interest component of the market rate," and is accordingly "considered part of the cost of capital." *Ibid.*; see also Patrick Halligan, *Cramdown Interest, Contract*

Damages, and Classical Economic Theory, 11 AM. BANKR. INST. L. REV. 131, 162 (2003) ("Ordinary markups or profits really are just a component of cost, namely, of the cost of capital"). Now-Professor Zywicki explains:

> "Profit" is actually the cost of deferring present consumption until a later time, and the tradeoff within a creditor's business between alternative methods of financing. Even if payment was guaranteed and inflationary expectations were zero, the real interest rate would still be positive, because it reflects "the price required to induce a lender to effect an exchange between current and future consumption." Thus, there is no "profit" from enticing deferred compensation.

Zywicki, *supra*, 19 THURGOOD MARSHALL L. REV. at 261 (footnotes omitted). This "profit" is included even in a risk-free rate like the Treasury rate, and no one disputes that this return should be included in the "present value" discount rate. Indeed, *Rash* ensured that creditors were entitled to this form of "profit" by requiring that the allowed amount of the secured claim be based on the value of the collateral at its fair market price. In order to assure that the creditor receives this value under a cramdown plan, the statute requires that the payments provided for in the plan include a market rate of interest.

C. Petitioners Ask The Court To Presume Away Transaction Costs.

Finally, petitioners erroneously presume that the market lending rate will include various transaction costs that the creditor would not incur in bankruptcy. In commercial financing in Chapter 11 cases, however, these costs are trivial in comparison to the overall amount of the secured claim and have little effect on the interest rate. See, *e.g.*, *Bank of America Nat'l Trust & Sav. Ass'n* v. *203 North LaSalle St. P'ship*, 526 U.S. 434, 440 (1999) (bank had $54.5 million secured claim); *Cellular Info.*

Sys., 171 B.R. at 929 (banks had $94.5 million secured claim). And any such costs are likely to wash out in any event. Administering a loan to a debtor in bankruptcy has its own unique costs. See Zywicki, *supra*, 19 THURGOOD MARSHALL L. REV. at 259 ("It is doubtful * * * that there will be any net decrease in administrative costs when a secured claim becomes a cramdown claim in bankruptcy"). Accordingly, "[w]hile some administrative costs will already have been incurred, and thus saved, * * * the 'legal, managerial, and clerical costs in monitoring and accounting' for a bankruptcy claim will at least offset these savings." *Ibid.* As one court observed, "a creditor almost certainly incurs legal, managerial, and clerical costs in monitoring and accounting for a Chapter 13 claim that are not present in a standard loan situation. Rather than being less, it appears to the court that there is a good chance that the creditor's transaction costs increase for bankruptcy claims." *Cassell*, 119 B.R. at 92; see also *General Motors Acceptance Corp.*, 999 F.2d at 68 (the creditor "retains some monitoring and other relational costs in its dealings with the trustee and the bankruptcy court, and it is unclear as an empirical matter whether [the creditor's] net costs in this area increase or decrease with the introduction of a cramdown").

Once again, moreover, this is an issue to take up with the bankruptcy court. If the debtor believes that the market rate assumes costs that the creditor no longer faces, the debtor can offer evidence to that effect and argue for a downward reduction to that rate.

V. Petitioners' Approach Would Have Harmful Consequences.

By denying creditors compensation for risk, return on capital, and administrative costs, petitioners' "formula" would grossly underpay secured creditors in bankruptcy. As we have shown, this undercompensatory "formula" is inconsistent with the text of the Code and this Court's decision in *Rash*. It will

also bring about adverse consequences for borrowers and lenders alike.

Lenders will need to recoup amounts lost in bankruptcy by raising the rates and fees they charge all borrowers:

> [A]ny redistribution afforded debtors as a class as a result of [a] pro-debtor bankruptcy rule will be eliminated by the increased rate creditors will charge initially. The apparent pro-debtor effects of the bankruptcy rule will be eliminated by the increased interest rates charged to debtors as a class. At the same time, debtors who end up in bankruptcy will receive a windfall, as they will reap the rewards of the pro-debtor bankruptcy rule.

Zywicki, *supra*, 19 THURGOOD MARSHALL L. REV. at 263; see also *In re Rash*, 90 F.3d 1036, 1073 n.17 (5th Cir. 1996) (Smith, J., dissenting) (observing that, under the majority's rule appraising collateral based on its foreclosure value, lenders would raise rates, which "might have adverse economic consequences, redistributing wealth from responsible debtors to bad credit risks and thereby forcing good risks out of the credit market"), rev'd, 520 U.S. 953 (1997). In short, everyone will have to pay more for their loans, and borrowers who manage to remain solvent will be penalized as they are forced to subsidize the below-market rates imposed on creditors in cramdown.

The higher loan rates that petitioners' approach would inevitably spawn would make it more difficult for some borrowers to obtain credit at all, putting a damper on consumer spending and increasing pressure on businesses. Companies seeking to obtain capital, hire new employees, or just stay afloat will have to pay higher interest rates to secure needed financing. For some companies, the increases will make it impossible to obtain credit, meaning they will have to forego expansion or cease operations altogether. Others will borrow,

but the higher rates will be more likely to ultimately precipitate default and bankruptcy. Petitioners argue that higher cramdown rates will force some Chapter 13 debtors into Chapter 7 liquidation, but (even if true) this is surely better than forcing a welter of additional corporate and individual borrowers into bankruptcy in the first place, making credit unaffordable for others, and providing still others with loans bearing higher interest rates than they otherwise would. Petitioners' plan to undercompensate creditors in bankruptcy is certain to have all of these effects.

CONCLUSION

The Seventh Circuit's judgment should be affirmed.

Respectfully submitted.

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